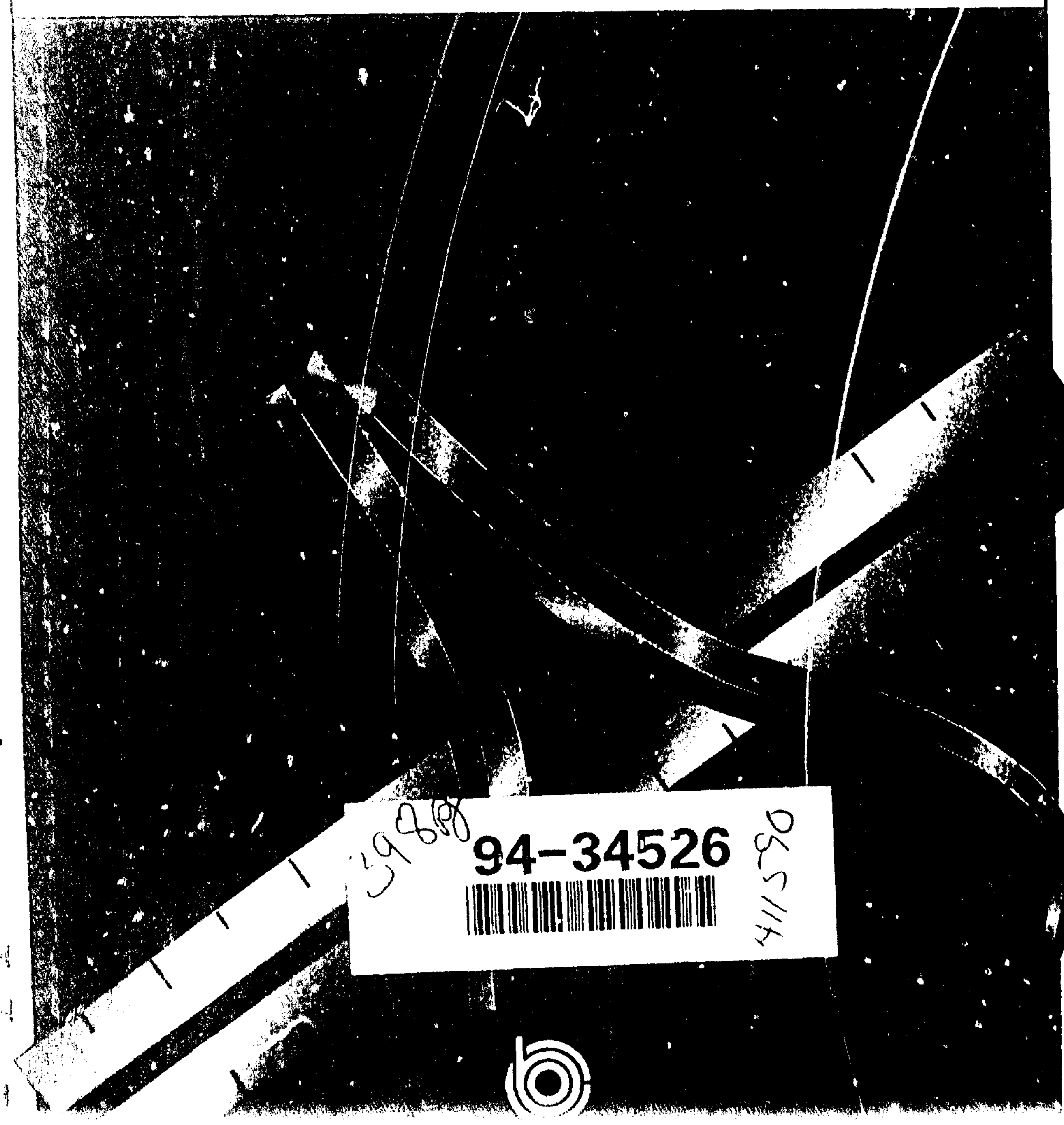
CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

Reducing the Deficit: Spending and Revenue Options

A Report to the Senate and House Committees on the Budget

As Required by Public Law 93-344



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REDUCING THE DEFICIT: SPENDING AND REVENUE OPTIONS

The Congress of the United States
Congressional Budget Office

NOTES

Unless otherwise indicated, all years referred to in this report are fiscal years.

Numbers in the text and tables of this report may not add to totals because of rounding.

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Preface

This volume compiles nearly 200 specific policy options for increasing federal revenues or reducing spending in a wide variety of federal programs. This is the 15th such compendium that the Congressional Budget Office (CBO) has prepared as part of its annual report to the House and Senate Committees on the Budget. Over the years, this report has become a standard reference for developing deficit reduction plans.

The 197 specific policy options included in this report come from many sources, and most have been considered by the Congress at some time in the past. In accordance with CBO's mandate to provide objective and impartial analysis, the discussion of each option presents the cases for and against it as fairly as possible. CBO does not endorse the options included, nor does exclusion of any proposal imply a recommendation.

The report begins with an introductory chapter that provides general background information on CBO's latest deficit projections and reviews the actions taken in the 1990 and 1993 deficit reduction efforts. The next three chapters present 161 options for reducing spending, organized by broad categories that have become the focus for deficit reduction efforts--defense and international discretionary spending, domestic discretionary spending, and entitlements and other mandatory spending. The last chapter presents 36 revenue-generating options. The report concludes with an appendix listing the spending options by the budget functions that would be affected and a glossary of budget and economic terms.

The economic assumptions and baseline budget projections underlying the estimates of spending reductions and revenue increases contained in this volume are described in more detail in the first volume of CBO's annual report, *The Economic and Budget Outlook: Fiscal Years 1995-1999* (January 1994).

All divisions of the Congressional Budget Office contributed to this report, which was coordinated by James L. Blum. Philip Joyce prepared Chapter 1. The options presented in Chapters 2 through 5 were coordinated by Mark B. Booth, David H. Moore, R. Mark Musell, Constance Rhind, and Neil M. Singer. Budget authority and outlay estimates were coordinated by Michael A. Miller, William P. Myers, Charles E. Seagrave, and Robert A. Sunshine. Revenue estimates were prepared by the staffs of the Congressional Budget Office and the Joint Committee on Taxation and were reviewed by the Tax Analysis Division of CBO under the supervision of Rosemary D. Marcuss.

Paul L. Houts and Sherry Snyder supervised the editing and production of the report. Major portions were edited by Paul L. Houts, Sherry Snyder, Sherwood D. Kohn, and Leah Mazade. Christian Spoor provided editorial assistance during production. The authors owe special thanks to Mary Braxton, Sharon Corbin-Jallow, Judith Cromwell, Denise Jordan, Ronald Moore, Simone Thomas, and Donna Wood, who typed the many drafts. Kathryn Quattrone and Martina Wojak-Piotrow prepared the report for publication.

Robert D. Reischauer
Director

March 1994

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Chapter One

Curbing the Long-Run Growth of the Federal Budget Deficit Requires Further Policy Actions

The first session of the 103rd Congress saw the passage of the second multiyear deficit reduction package in three years. Each of these two packages resulted in deficit reduction in excess of $400 billion, and the projected path of federal budget deficits is significantly lower today than it would have been without the 1990 and 1993 actions. But despite these two significant deficit reduction packages, the Congressional Budget Office (CBO) projects that annual deficits will remain in the $200 billion range in the short run and will increase both in dollar terms and as a percentage of gross domestic product (GDP) once again by the turn of the century. For this reason, further policy actions are necessary if the deficit is to be brought down, and are most certainly necessary if the budget is to be brought into balance.

The Economy and the Deficit

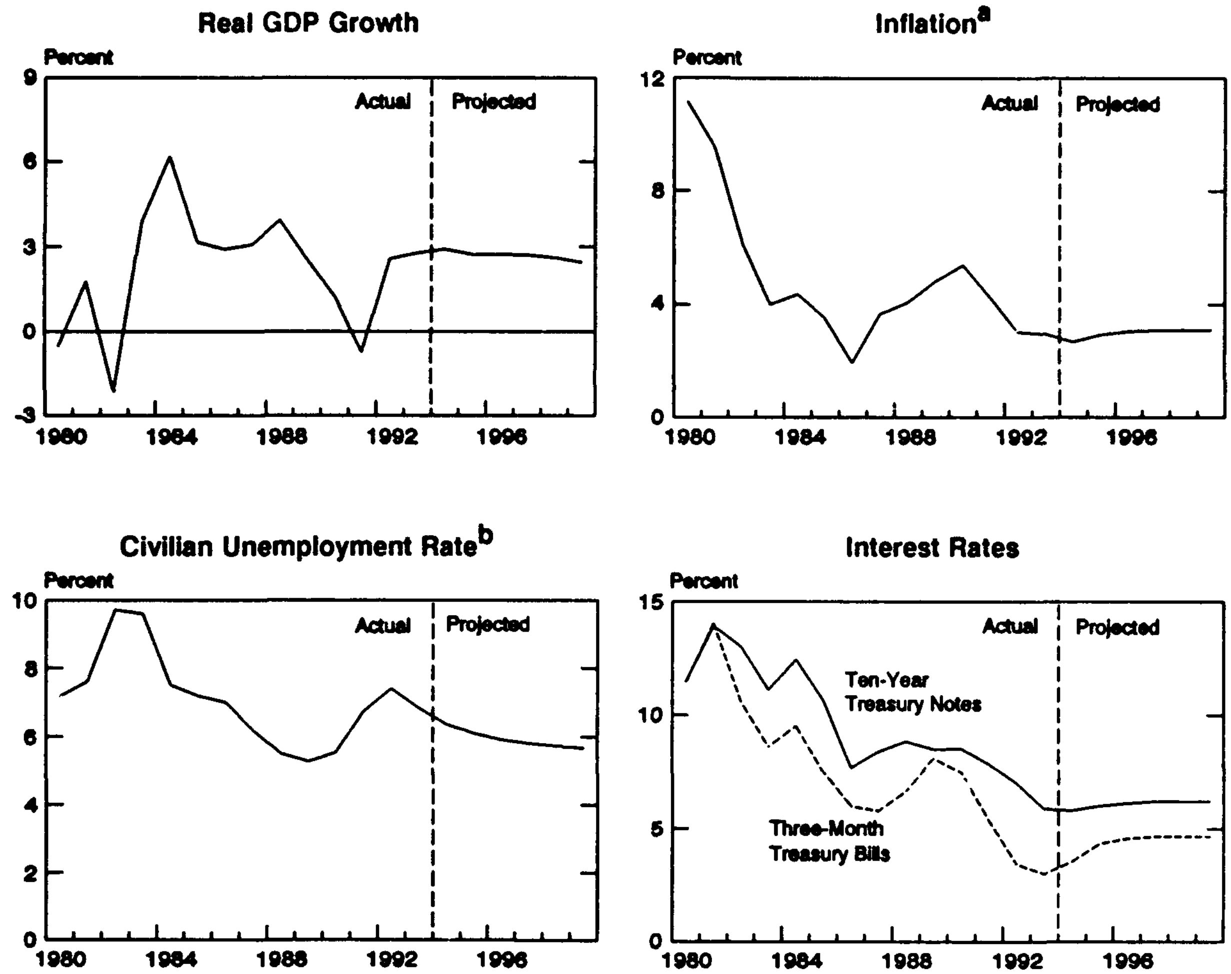
CBO forecasts that real GDP will grow at an annual rate of nearly 3 percent through 1995 (see Figure 1). The combination of moderate economic growth and an increasing number of people actively looking for work will result in a gradual decline in the unemployment rate--from the 6.4 percent reported for December 1993 to 6.0 percent at the end of 1995. The consumer price index is expected to grow at around 3 percent annually through 1995. The rate on three-month Treasury bills is projected to increase from 3.1 percent at the end of 1993 to 4.5 percent at the end of 1995, and long-term rates are expected to rise slightly over the same period as well.

Over the medium term (1996 through 1999), CBO projects that potential real GDP will grow at an average annual rate of about 2.4 percent. (Potential GDP is the maximum level of output that can be maintained without igniting inflation, based on such factors as growth in the labor force, national saving, and productivity.) Projected growth of real GDP will exceed that rate through 1999--CBO assumes average annual growth of 2.6 percent in 1996 through 1999. As a result, the gap between actual and potential GDP would shrink from 2.0 percent at the end of 1993 to its historical average of 0.6 percent in 1999. Steady growth at that pace would push down unemployment to 5.7 percent in 1999. Because GDP, on average, remains below its potential, the projected rate of inflation will be steady. The projections assume a slight increase in both short- and long-term interest rates during the 1996-1999 period.

One factor that can significantly affect the ability of the economy to sustain real growth and remain healthy in the long run is the federal budget deficit. Amid the concern that U.S. living standards may grow more slowly in coming decades than they did during most of the postwar period, reducing the budget deficit continues to be an important focus of attention because it will increase national saving. In

fact, reducing the deficit is the most reliable way to improve national saving. Over the long run, a permanently higher rate of saving would stimulate new investment, increase productive capacity, lower real interest rates, and raise the nation's standard of living. Decreasing federal spending on consumption and increasing spending on well-chosen public investments would also spur economic growth, but is not likely to be an effective substitute for the increased private investment that would stem from a lower federal deficit. Further, although the deficit has been decreased substantially since 1990, it will begin to rise again as a percentage of GDP by late in this century.

Figure 1.
The Economic Forecast and Projection



SOURCES: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics; Department of Commerce, Bureau of Economic Analysis; Federal Reserve Board.

NOTE: All data are annual values; growth rates are year-over-year.

a. Consumer price index for all urban consumers (CPI-U). The treatment of home ownership in the official CPI-U changed in 1983. The inflation series in the figure uses a consistent definition throughout.

b. Calculated using the 1993 methodology; published rates are likely to be higher.

The Outlook for the Deficit Over the Next 10 Years

The outlook for the deficit is distinctly rosier than it was a year ago, largely because of the substantial tax increases and spending cuts enacted by the Congress last August in the Omnibus Budget Reconciliation Act of 1993 (OBRA-93). The actions taken in 1993--and the earlier deficit reduction actions taken in November 1990--have resulted in a substantial improvement in the long-run deficit picture from what would have occurred without those legislative steps.

The deficit problem, however, is not over. CBO's projections indicate that, even accounting for the changes resulting from these two actions, the deficit will continue to be unacceptably high between now and fiscal year 2004 (see Table 1). These projections, which assume that current laws are not changed and that discretionary spending keeps up with inflation once the Budget Enforcement Act's (BEA's) statutory caps on discretionary spending expire, indicate that deficits will decline from $223 billion in fiscal year 1994 to $166 billion by fiscal year 1996. After that point, however, the deficit is projected to rise again, exceeding $300 billion again by fiscal year 2003. As a percentage of GDP, the federal deficit would decline to a low of 2.2 percent in 1996 (down from a high of 4.9 percent in 1992), but would grow to 3 percent again soon after the beginning of the next decade. The ratio of federal debt to GDP would also begin to climb again around the turn of the century.

Table 1.
Baseline Deficit Projections, Fiscal Years 1993-2004

	Total Deficit Assuming Discretionary Caps	
	In Billions of Dollars	As a Percentage of GDP
1993	255	4.0
1994	223	3.4
1995	171	2.4
1996	166	2.2
1997	182	2.3
1998	180	2.2
1999	204	2.4
2000	226	2.5
2001	256	2.7
2002	288	2.9
2003	324	3.1
2004	365	3.3

SOURCE: Congressional Budget Office.

NOTE: GDP = gross domestic product.

The projected growth in the deficit will continue to be fueled by the growth of spending for the government's health care programs--Medicare and Medicaid. These programs not only are projected to almost triple in size in dollar terms, but each will almost double as a percentage of GDP over the period as well. Adopting a plan that substantially reforms the nation's health care system might slow the future growth of such spending, but that positive effect on the deficit might be more than offset--at least in the short to intermediate term--by the costs of expanding health care coverage to people who are currently uninsured.

In contrast, discretionary spending is projected to decline as a percentage of GDP over the period under current law, if the caps for 1994 through 1998 are complied with and no real growth occurs in discretionary spending between 1999 and 2004. The projections assume that revenues remain a fairly constant percentage of GDP throughout the period, as is implied by current law. Although all budget projections (particularly those extending far into the future) are imprecise, these projections represent CBO's best guess of where the federal budget is headed if current laws and policies are not changed. (For more details on both the economic and budget outlook, see Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1995-1999,* published in January 1994.)

The imperative for additional deficit reduction would become particularly acute if the Congress were to enact, and the states were to ratify, a balanced budget amendment to the Constitution. This

amendment is scheduled to be considered again this year and may take effect as soon as fiscal year 1999, a year in which the deficit is projected to be $204 billion. If the amendment is adopted, the need to consider a further reduction in the deficit will be even more immediate, as a deficit reduction of that size is most unlikely to occur in any one year. Consequently, making the kinds of policy choices represented by the options in this volume will become more necessary than ever.

What Happened to Deficit Reduction in 1990 and 1993?

If another large package of deficit reduction actions is to be attempted, the 1990 and 1993 deficit reduction packages could serve as guides. Each of these packages was the product of an era in which the primary focus of the budget process has been on deficit reduction. Reviewing what actions were taken can provide some insights into which of them might be attempted in a third such package.

The 1990 Budget Plan

The explosion of the federal budget deficit in the early 1980s resulted in a great deal of frustration with the inability of the Congress and the President to control it. In response to this frustration, the Congress passed the Balanced Budget and Emergency Deficit Control Act of 1985, popularly known as the Gramm-Rudman-Hollings (GRH) legislation. GRH had a simple goal--to reduce the size of the deficit to specified levels each year until expenditures were in balance with revenues. According to the targets specified in the legislation, the budget was to be balanced by fiscal year 1991 (in a 1987 rewrite of the legislation, this date was changed to fiscal year 1993). But the deficit did not come down as promised by the Gramm-Rudman-Hollings legislation. In an effort to live within the short-term budget constraints, the President and the Congress circumvented the targets by relying on overly optimistic economic assumptions and short-term budget fixes. This strategy enabled policymakers to appear to live within the annual constraints, while actually doing little to reduce the deficit. By early 1990, it was obvious that the balanced budget target was not going to be reached. The deficit in 1993 (the year in which the revised targets were to require a balanced budget) turned out to be $255 billion.

Largely because of the failures of GRH to reduce the deficit as planned, a five-year budget plan was enacted into law in November 1990, with two major components. First, the Omnibus Budget Reconciliation Act of 1990 (OBRA-90) and several companion measures reduced the deficit by almost $500 billion over a five-year period (1991 through 1995), by a combination of tax increases, mandatory spending cuts, and limits on discretionary spending. Those new laws increased net revenues by an estimated $158 billion over the five-year period; the increased revenues included income tax changes affecting high-income taxpayers, an additional tax of 5 cents per gallon on motor fuels, and new or increased excise taxes on various goods (see Table 2). Entitlement spending was reduced by $75 billion, more than half of which ($42 billion) came from reducing Medicare spending. The savings on discretionary spending (a total of $189 billion) resulted from a combination of enacted savings in 1991 appropriation bills and new caps that were to limit future appropriations through 1995. The majority of the enacted and proposed savings in discretionary spending were to come from the defense budget. The actions taken as a result of OBRA-90 and the appropriation limits were also estimated to reduce debt-service payments by a total of $59 billion over the five years.

In addition, the 1990 package established the Budget Enforcement Act, whose primary purpose was to ensure that the savings agreed to in the deficit reduction accord would be realized. Two major sets of rules for enforcement were included. The first of these was the discretionary spending caps on appropriations for fiscal years 1991 through 1995. For fiscal years 1991 through 1993, annual ceilings on budget authority and outlays were established for the three categories of discretionary spending--defense, domestic, and international. After 1993, caps on budget authority and outlays exist only for the total of discretionary spending. Compliance with

the appropriation caps is enforced through a sequestration of discretionary spending. The second major enforcement mechanism included in the BEA is the pay-as-you-go (PAYGO) process. This set of rules requires that legislative actions affecting entitlements and other mandatory spending as well as revenues not increase the deficit in any year. If this condition is not met, the PAYGO discipline is enforced through a separate sequestration of the resources available to a prescribed and limited number of mandatory programs, such as Medicare and farm price supports.

Table 2.
Major Elements of Deficit Reduction Under OBRA-90 (By fiscal year, in billions of dollars)

	1991	1992	1993	1994	1995	Five-Year Total
Revenues						
Increases in taxes on high-income individuals	-2.4	-8.1	-8.9	-9.9	-10.9	-40.2
Increase in Medicare taxable ceiling to $125,000	-1.8	-5.7	-6.1	-6.4	-6.8	-26.9
Imposition of 5 cents per gallon motor fuels tax	-4.4	-5.2	-5.1	-5.1	-5.2	-25.0
Increase in tobacco and alcohol taxes	-1.8	-2.6	-3.4	-3.4	-3.4	-14.6
Extension and modification of telephone tax	-1.6	-2.6	-2.8	-2.9	-3.1	-13.1
Increase in Airport and Airway Trust Fund taxes	-1.4	-2.3	-2.5	-2.7	-3.0	-11.9
Extension of OASDI coverage to certain state and local government employees	-0.4	-2.0	-2.1	-2.3	-2.4	-9.2
Change in accounting rules applying to insurance companies	-1.6	-1.8	-1.8	-1.7	-1.6	-8.6
Expansion of earned income tax credit	a	0.3	0.3	0.4	0.7	1.7
Other	-2.3	-2.9	0.4	-3.0	-2.9	-10.6
Subtotal	-17.8	-33.0	-31.9	-37.0	-38.7	-158.4
Mandatory Spending						
Medicare	-3.3	-5.7	-8.8	-11.2	-13.4	-42.5
Federal employee retirement and health benefits	-2.3	-2.1	-3.1	-3.3	-3.7	-14.5
FDIC premiums	-1.1	-1.8	-1.9	-2.1	-2.1	-9.0
Farm programs	0.6	-0.4	-1.1	-1.5	-1.7	-4.1
Veterans' benefits	-0.6	-0.8	-0.7	-0.7	-0.8	-3.6
Federal Housing Administration reforms	-0.6	-0.8	-0.7	-0.9	-0.6	-3.6
Federal Family Education Loans	0	-0.1	-0.3	-0.6	-0.7	-1.7
Refundable earned income tax credit	0.2	2.5	3.2	4.1	6.7	16.6
Other	-2.1	-3.2	-2.6	-2.3	-2.4	-12.5
Subtotal	-9.3	-12.3	-16.0	-18.6	-18.7	-74.9
Discretionary Spending	-5.5	-19.3	-31.6	-57.9	-75.1	-189.4
Debt Service	-0.7	-4.3	-9.9	-17.5	-27.1	-59.5
Total Deficit Reduction	-33.3	-68.8	-89.3	-131.0	-159.7	-482.1

SOURCE: Congressional Budget Office.

NOTES: A less detailed version of these estimates was published in Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1992-1996* (January 1991); revenue increases are shown with a negative sign because they reduce the deficit.

OBRA-90 = Omnibus Budget Reconciliation Act of 1990; OASDI = Old-Age, Survivors, and Disability Insurance; FDIC = Federal Deposit Insurance Corporation.

a. Less than $500 million.

The BEA was generally successful in its first three years in enforcing compliance with the deficit reduction actions. The discretionary spending caps held; the appropriations committees and the Congress lived within their limits in fiscal year 1992 and actually reduced appropriations to a level below the caps in fiscal years 1993 and 1994. The pay-as-you-go process seems to have discouraged major efforts either to increase entitlement spending or to cut taxes.

Nonetheless, the deficit did not come down to the levels promised in 1990. When the BEA was enacted, policymakers believed that the deficit would be lowered substantially, but the BEA included no requirement for additional deficit reduction if this outlook worsened. In the end, the deterioration of the economy and failure to project explosive growth in programs such as Medicare and Medicaid were largely responsible for the increase in the projected deficits since 1990. Virtually none of the change in the deficit outlook after OBRA-90 resulted from legislative actions. Still, the continuing high deficits occasioned another effort to reduce them, which culminated in the passage of the Omnibus Budget Reconciliation Act of 1993.

OBRA-93

Mindful of the need to reduce federal red ink further, President Clinton in 1993 proposed another five-year deficit reduction package. The goal of this plan was to reduce cumulative budget deficits by a total of $500 billion between 1994 and 1998. The Congress adjusted the proposal somewhat, but OBRA-93, enacted in August of last year, eventually codified a new five-year deficit reduction plan. It included revenue increases, discretionary spending cuts, and new, more stringent limitations on discretionary spending. The BEA's enforcement procedures, including the discretionary caps and the PAYGO process, were extended through 1998. (Table 3 summarizes the results of the 1993 deficit reduction actions.)

By CBO calculations, OBRA-93 reduced the projected deficits by $433 billion over the 1994-1998 period, through a combination of four types of actions.[1] First, the package included a total of $241 billion in revenue increases. Almost half of these increases came from raising income tax rates for high-income individuals. Other components of the revenue increase included raising the motor fuels tax again, repealing the cap on earnings subject to the Medicare tax, and increasing the taxable portion of Social Security benefits. Second, the package included a total of $77 billion in reductions in mandatory spending, about 70 percent of which ($56 billion) came from reductions in Medicare. Third, the extension of the discretionary spending caps is estimated to save an additional $68 billion. Finally, the aforementioned changes would reduce debt-service payments by $47 billion.

Planning the Size and Makeup of Another Deficit Reduction Package

How much further should the deficit be reduced? There is no apparent consensus on this issue. By way of comparison, each of the last two budget reconciliation agreements provided for more than $400 billion in spending cuts and tax increases over five years. Users of this volume might consider another package of roughly that size. One additional way to approach the issue of appropriate size is to assume a level of deficit reduction necessary to eliminate the deficit in fiscal year 1999, the earliest year in which the proposed constitutional amendment to require a balanced budget would take effect. Eliminating the deficit through actions taken in the 1995-1999 period would necessitate total reductions of $600 billion over that period--a substantially larger reduction than that achieved by OBRA-93. Of this $600 billion, almost $530 billion would need to come through the kinds of policy actions included in this volume. The remainder would come through the accompanying debt-service savings.

What is the appropriate mix of revenue increases and spending cuts in a deficit reduction

1. The $433 billion calculation is the level of deficit reduction if the value of OBRA-93 is computed relative to the CBO capped baseline, which assumed that the caps set by the 1990 Budget Enforcement Act are complied with. For more details on the budgetary effect of OBRA-93, see Congressional Budget Office, *The Economic and Budget Outlook: An Update* (September 1993).

Table 3.
Major Elements of Deficit Reduction Under OBRA-93 from the CBO Winter 1993 Baseline
(By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	Five-Year Total
Revenues						
Increase in tax rate for high-income individuals	-15.4	-22.8	-25.7	-24.6	-26.3	-114.8
Extension and increase of motor fuels tax	-4.4	-4.5	-7.4	-7.5	-7.5	-31.3
Repeal of cap on earnings subject to Medicare tax	-2.8	-6.0	-6.4	-6.8	-7.2	-29.2
Increase in taxable portion of Social Security benefits	-1.9	-4.6	-5.3	-6.0	-6.7	-24.6
Increase in corporate tax rate	-4.4	-2.8	-2.9	-3.1	-3.2	-16.4
Reduced business meal and entertainment deduction	-1.8	-3.1	-3.3	-3.4	-3.6	-15.3
Expansion of earned income tax credit	a	0.2	0.4	0.5	0.6	1.7
Other	4.3	0.2	-0.9	-9.8	-4.6	-10.8
Subtotal	-26.4	-43.5	-51.5	-60.7	-58.5	-240.6
Mandatory Spending						
Medicare	-2.1	-5.5	-11.6	-16.4	-20.2	-55.8
Federal employee retirement and health benefits	-0.4	-0.8	-2.9	-3.7	-4.0	-12.0
FCC electromagnetic spectrum auction	-1.7	-1.8	-1.7	-1.0	-1.0	-7.2
Medicaid	a	-1.0	-1.6	-2.1	-2.5	-7.1
Federal Family Education Loans	-0.6	-0.4	-0.8	-1.2	-1.2	-4.3
Veterans' benefits	-0.2	-0.4	-0.4	-0.4	-1.2	-2.6
Farm programs	-0.1	-0.7	-0.5	-0.6	-0.5	-2.5
Refundable earned income tax credit	0.2	2.0	4.4	6.1	6.4	19.1
Food stamps	a	0.2	0.4	0.8	1.0	2.5
Other	-0.3	-0.2	-1.8	-2.4	-2.5	-7.2
Subtotal	-5.3	-8.5	-16.6	-20.9	-25.7	-76.9
Discretionary Spending	0	0	-7.7	-23.0	-37.9	-68.5
Debt Service	-0.9	-3.4	-7.5	-13.6	-21.3	-46.8
Total Deficit Reduction	-32.6	-55.5	-83.3	-118.1	-143.4	-432.9
Memorandum: Deficit Reduction from Alternative Baselines						
Reduction from the CBO Uncapped Baseline[b]	-47.4	-83.2	-111.8	-147.4	-174.5	-564.4
Reduction from the CBO Estimate of the Administration's Baseline[c]	-42.0	-72.9	-94.1	-123.7	-144.3	-476.9

SOURCE: Congressional Budget Office.

NOTES: The CBO winter 1993 baseline assumed compliance with the discretionary spending limits of the Budget Enforcement Act through 1995. Discretionary outlays were assumed to grow at the same pace as inflation after 1995. See Congressional Budget Office, "An Analysis of the President's February Budgetary Proposals," CBO Paper (March 1993).

Revenue increases are shown with a negative sign because they reduce the deficit.

OBRA-93 = Omnibus Budget Reconciliation Act of 1993; FCC = Federal Communications Commission.

a. Less than $500 million.

b. The CBO March 1993 uncapped baseline assumed that discretionary outlays would grow from 1993 appropriated levels at the same pace as inflation through 1998.

c. CBO's estimate of the Administration's baseline assumed that discretionary outlays for nondefense accounts would grow from the 1993 appropriated levels at the same pace as inflation. Defense discretionary outlays equaled the amounts requested in the Bush Administration's January 1992 budget request (with various adjustments by the Clinton Administration).

package? Again, there is no absolute answer, but it would surely be difficult to enact a large package of deficit reduction actions--as was enacted in 1990 and 1993--that relied solely on either cuts in spending or increases in revenue. As an illustration, in the path alluded to above, a package that eliminated the deficit by fiscal year 1999 by cutting spending alone would require spending reductions of more than 11 percent. The increases in taxes would be an almost identical percentage if only revenue increases were used to balance the budget. If there are to be large, multiyear deficit reduction packages in the future, they will probably have to rely on a mix of spending and revenue actions. For this reason, policy actions that would both increase revenues and decrease spending are included in this volume.

The 1990 and the 1993 deficit reduction packages relied on many of the same sources for reducing the deficit. On the revenue side, the OBRA-90 agreement included a healthy dose of increases that tended to be targeted toward high-income individuals, through a combination of increasing marginal tax rates and phasing out or limiting exemptions and deductions; the percentage of revenue increases coming from this source was even bigger in OBRA-93. On the spending side, reductions in the defense budget have enabled the discretionary spending caps to be complied with to date without the need for substantial reductions in domestic appropriations. Further, the Medicare program has contributed the largest share to reductions in mandatory spending. The types of actions--increasing taxes on high-income people, cutting the defense budget, and reducing Medicare spending--that have made up the majority of the savings in the first two rounds may be more difficult to rely on in a third.

Revenues. Most striking about the 1990--and particularly the 1993--tax actions was the relatively large portion of the increases that fall on higher-income taxpayers. For example, CBO estimates that 37 percent of the total additional revenues collected as a result of OBRA-90 were collected from families in the top 1 percent of the income distribution. In OBRA-93, the effect on families in the top 1 percent was much more pronounced, with 76 percent of the added taxes being paid by this group. The desirability of further increasing taxes on high-income people is a matter of some debate: CBO estimates that the 1990 and 1993 actions have resulted in higher-income families' paying the same share of their income as taxes as comparable families did in 1977 (for an expanded discussion, see the introduction to Chapter 5). Although middle-income taxpayers were affected by excise tax increases enacted in 1990 and 1993, they were largely untouched by the increases in income taxes.

Defense. Since the passage of the BEA in 1990, the largest portion of discretionary savings has come from the defense budget. The cuts in the defense budget have permitted the discretionary caps to be reached without any reduction--in inflation-adjusted terms--in other discretionary spending. But these cuts have reduced armed forces personnel and have dislocated other workers in areas of the country that rely on defense employment, making the prospects of further reductions of this magnitude speculative at best (see Table 4). This situation is exacerbated

Table 4.
Comparisons of Defense and Other Discretionary Appropriations, Fiscal Years 1990-1994
(In billions of dollars)

	Defense	Other Discretionary Spending[a]	Total Discretionary
1990	304.4	182.1	486.8
1991	287.9	202.5	490.4
1992	285.9	220.1	505.9
1993	277.1	227.0	504.2
1994	262.0	238.0	500.0
Percentage Change for 1990-1994 Period	-13.7	30.7	2.8

SOURCE: Congressional Budget Office.

NOTE: Excludes emergency spending, the majority of which occurred in the defense category in 1991 and 1992 to cover the costs of Operation Desert Storm.

a. Includes the Budget Enforcement Act categories of international and domestic discretionary spending.

by recent changes in the world, which suggest that it is still an uncertain place in which to live.

Medicare. The Medicare program has borne the brunt of mandatory spending reductions in 1990 and 1993. Moreover, although health care spending is by far the biggest culprit in the rise in mandatory spending, the possibility that the Congress will enact comprehensive health care reform has implications for the role that Medicare and other health programs may play in future deficit reduction efforts. Though reductions such as the ones included in this volume may be enacted, there is likely to be some disagreement over how these savings will be used. Some policymakers may choose to dedicate the savings to deficit reduction, while others may want to use the savings from changes in existing programs to finance expansions in services or coverage that may result from comprehensive health care reform.

In short, the three biggest single contributors to the two recent deficit reduction efforts--tax increases on the wealthy, decreases in the defense budget, and reductions in health care spending--may play a lesser role in the next round of deficit reduction. If so, it means that if and when the next major deficit reduction agreement comes, it will probably involve different kinds of actions--and ones that the political system has found it difficult or unnecessary to take so far.

How to Use This Report

This volume presents a menu of options that could be used to make policy choices to reduce the deficit. Users of this report will be able to select options, based on their own policy preferences, that could contribute to decreasing federal red ink.

The policy options for deficit reduction, which include both those that would decrease spending and those that would increase revenues, are presented in the four remaining chapters of this report. Chapters 2 and 3 cover the discretionary front--national defense (including international programs) in Chapter 2, and domestic programs in Chapter 3. Chapter 4 covers entitlements and other mandatory programs and also presents options that involve raising user fees. Chapter 5 discusses options that would raise tax revenues.

Each of the options starts with a table showing annual and cumulative five-year savings. For an entitlement program, the numbers in these tables show the difference between what the program would cost under the CBO baseline, which assumes continuation of current law, and what it would cost (in millions of dollars) under the proposed modification. In the case of revenues, the entries show the increase in tax collections (in billions of dollars)--over and above those due under current law--that would take place if the option were enacted.

For discretionary programs, the tables compare the savings with a baseline in which the assumed level of appropriations equals the actual 1994 appropriation increased for projected inflation. Because this baseline does not incorporate the discretionary spending limits imposed by the Budget Enforcement Act for 1994 through 1998, it is often termed the uncapped baseline. In contrast, the CBO deficit projections described earlier assume that the discretionary spending limits are met (see Table 5).

In developing a deficit reduction plan, users of this volume should subtract the savings for their chosen options from the deficits in the uncapped baseline. Just to reach the deficits in the CBO baseline, they will have to select options that reduce discretionary outlays by $11 billion in 1995, $19 billion in 1996, and $166 billion over the 1995-1999 period. But even this understates the difficulty of meeting the caps for many federal agencies, since the uncapped baseline does not assume full funding of pay increases (including locality pay) under current law for many federal employees. Funding these increases will force many agencies to identify cuts in other parts of their budgets over and above those needed just to bridge the gap between the uncapped baseline and the CBO baseline.

The path of the Clinton Administration's defense budget offers much of the savings needed to reach the CBO baseline from the uncapped baseline. Compared with the uncapped baseline, CBO estimates that the Administration's 1995 budget would reduce defense outlays by $2 billion in 1995, $16

billion in 1996, and $117 billion over the 1995-1999 period (see Table 6 in Chapter 2 for additional details). Many users of this volume may want to start by assuming all of the reductions inherent in this year's budget request. In fact, most of the defense options are constructed with this year's request in mind.

The specific options that are included in this volume came from various sources, such as past Presidential budget proposals, past legislative proposals, and the suggestions of various private groups. Others have been developed by CBO staff. In none of these cases is the inclusion of an option intended to communicate its endorsement by CBO. Further, this particular menu is meant to cover a broad range of options, and the exclusion of options does not necessarily imply that they lack merit. Finally, variations of these options are also possible. For example, tax rates could be raised by more or less than is contained in a specific option, or a decision could be made to change policies that affect spending by a lesser or greater amount than is indicated in a spending option. For each option, this volume presents the pros and cons of the various proposals. The decision as to whether to carry out any of them is for elected officials to make.

Numerous proposals have been made recently to decrease the deficit even further. These include candidate Ross Perot's 1992 proposal, a more recent plan put forward by the Concord Coalition, and numerous initiatives supported by Members of Congress (the best-known recent example was the proposal by Representatives Penny and Kasich, which was considered in the first session of this Congress). These proposals, and many others, have relied in part on past editions of *Reducing the Deficit* as source materials. Readers who wish to develop other such plans might also find the options in this volume to be a useful place to start.

Four general caveats are in order. First, virtually all of the options presented here would, in isolation, reduce employment temporarily. Accordingly, this particular drawback is not noted in each discussion. Similarly, all of the proposals to reduce grants to state and local governments would

Table 5.
Required Reductions in Discretionary Spending (By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	Cumulative Five-Year Total
Uncapped Baseline Deficit[a]	182.4	186.0	219.9	236.1	263.5	1,087.9
Reductions Required to Meet CBO Baseline						
Discretionary spending	-11.2	-19.0	-34.7	-50.7	-50.5	-166.1
Debt-service savings	-0.3	-1.2	-2.8	-5.4	-8.6	-18.3
Subtotal	-11.4	-20.2	-37.6	-56.1	-59.1	-184.4
CBO Baseline Deficit[b]	171.0	165.8	182.3	180.0	204.4	903.5

SOURCE: Congressional Budget Office.

a. The assumed level of discretionary appropriations in 1995 through 1999 equals actual 1993 appropriations increased for projected inflation and excludes emergencies.

b. Discretionary appropriations are held to the limits established by the Budget Enforcement Act through 1998 and are adjusted for inflation thereafter.

make their financial status worse, and that fact is not repeated in each discussion.

Second, some options may not be counted in meeting the BEA's requirements for implementation, even though they would reduce the deficit. An example would be a reduction in Social Security spending, which would not enter either the discretionary or PAYGO calculus, since Social Security was given its own limiting rule in the BEA. Generally, if the savings cannot be counted under the BEA, this caveat is noted in the write-ups of individual options.

Third, though all of the options, if devoted to deficit reduction, would reduce federal interest costs, these savings are not part of the calculations made. Ordinarily, when CBO is presented with a detailed budgetary plan, the individual options are "costed" as in this book, but a supplementary saving is calculated for the effect of the whole package on net interest spending. Moreover, when such budget packages are put together, one can adjust for any interactions among the parts that would raise or lower the savings--something that cannot be done for the options discussed here. The estimates do not take into account the possible gains or losses in GDP or other economic effects associated with large-scale deficit reduction. All options, instead, are evaluated against CBO's assumptions about the path of the economy.

Fourth, subsequent CBO cost estimates, which are required to accompany any bill reported by a Congressional committee, may not match exactly the numbers shown in this report. Policy proposals that are the subject of these subsequent cost estimates may not be identical to those analyzed in this book, or assumptions used in the analysis may differ. For example, certain individual options contained in *Reducing the Deficit* that affect federal employment assume that reductions can be accommodated without extra costs because of severance pay and early retirement programs. Further, future estimates may be compared with baselines that are different from the one used for the estimates that follow in this volume. Finally, estimates for individual years included in the options presented here have often been rounded to the nearest $5 million, $10 million, or $100 million.

Chapter Two

Defense and International Discretionary Spending

Budget authority for national defense has declined markedly in real terms since 1985, and further reductions are part of the Administration's plan for defense through 1999. In the past, defense cuts have been motivated by both budgetary pressures and geopolitical changes. Budgetary pressures will continue to influence the Congressional debate over defense spending for 1995 and beyond, as discussed in Chapter 1 of this volume. In particular, the fixed dollar limits on total discretionary outlays offer little room for new nondefense programs unless they are financed through additional cuts in defense spending.

Proponents of defense in the Congress and the Administration, however, argue that further reductions in defense spending would be unwise. They contend that the steady drawdown of military forces has reduced U.S. military capability at least as rapidly as the easing of world tensions has reduced the threat. They point to the Administration's Bottom-Up Review (BUR), organized last year by then Secretary of Defense Les Aspin, as justification for opposing further cuts in defense.

These conflicting arguments suggest that the debate over the 1995 defense budget will be contentious. To help inform that debate, this chapter presents 44 options for cutting spending in a wide range of defense and international programs. This introduction sets these choices in the broader context of the United States' national security objectives and economic constraints and discusses some of the criteria that might be applied in judging the merits of the individual options.

Threats to National Security

It is axiomatic that U.S. military forces must be strong enough to deter threats to national security at an acceptable level of risk and to defeat such threats if deterrence fails. In practice, this axiom translated for many years into strategic forces able to deter the nuclear threat posed by the Soviet Union, and conventional (nonnuclear) forces capable of simultaneously fighting a large war in Europe and a major regional conflict elsewhere. Smaller commitments, such as fighting insurgencies or projecting power in isolated parts of the globe, were largely subsumed in the major force requirements.

Geopolitical changes during the past few years have fundamentally altered the threats from which these requirements were derived. During the Cold War, the overriding danger to the United States was the global threat from the Soviet Union's nuclear and conventional forces. As stated succinctly in the Department of Defense's (DoD's) report on the BUR, in contrast, in today's world there is no single preeminent threat: instead, new dangers exist in the spread of nuclear, biological, and chemical weapons; aggression by regional powers; ethnic and religious conflicts; the potential for the failure of democratic reform efforts in the republics of the former Soviet Union and elsewhere; and the possibility that the United States' economy will fail to recover and grow.

These new threats have led some Members of the Administration and the Congress, including

some senior Members of the Committees on Armed Services, to conclude that further cuts in defense funding would endanger force structure, readiness, or modernization programs that are essential to national security. In support of their position, proponents of defense spending can point to a variety of global events, including North Korea's emerging nuclear program, the threat that hostilities in Bosnia will spread throughout the Balkans, and the persistence of ethnic strife in many of the republics of the former Soviet Union.

Threats such as these underlie the recommendations of the Bottom-Up Review. The forces recommended by the BUR, however, are not linked specifically to particular scenarios or warfighting plans. Instead, they constitute what the department believes are "sufficiently capable and flexible military forces . . . to fight and win two major regional conflicts nearly simultaneously." Left unanswered in the BUR report are many important questions: Would the Army divisions be heavily armored or light? Would there be sufficient air- and sealift to deploy to distant theaters? Could the reserves be mobilized and deployed rapidly enough to meet contingency plans? Does the Air Force need to modernize its fighter fleet to meet future threats? Such questions may be raised in Congressional review of the Administration's plan.

Economic and Budgetary Constraints

Both in the Congress and elsewhere, many voices have called for defense spending to be reallocated to other national needs. Suggested uses for the peace dividend have included virtually every type of federal program: national health care, tax relief, increased grants to states and localities, rebuilding the nation's transportation systems, aid to education, higher payments for Aid to Families with Dependent Children, space programs, and countless others.

As was discussed in Chapter 1, the spending ceiling incorporated in the Omnibus Budget Reconciliation Act of 1993 (OBRA-93) applies only to the aggregate of defense and nondefense appropriations. The Administration's plan for defense and nondefense spending constitutes one budgetary path consistent with the OBRA-93 caps. DoD's budget allocation, however, was insufficient to fund the forces recommended in the BUR and related investment programs because of higher projected inflation. This well-publicized shortfall has led some Members of Congress to call for increases in defense spending.

Nonetheless, there could well be pressure for significantly larger defense cuts. Supporters of the Administration's domestic agenda may want to finance their programs through reductions in defense spending. Congressional interest in deficit reduction remains strong, as shown by last year's close House vote on the plan offered by Congressmen Penny and Kasich. And even if a package of specific spending cuts beyond those implicit in OBRA-93's caps on discretionary spending is not enacted, further reductions might be mandated if the Congress passes a balanced budget amendment.

Effects of Alternative Reductions on Military Capability

The combination of budgetary constraints and reductions in the threat to U.S. security have already led to cuts in military forces and programs. The possibility that further cuts might be proposed raises the question of whether the remaining forces would be sufficiently capable to defend against foreseeable military threats. At issue are the size of these forces, their readiness to fight early in a war, and modernization of their weapons.

Size of Forces

Based on judgments expressed in the Bottom-Up Review, cuts in force levels below the levels of the Administration's plan would jeopardize the ability to meet U.S. military requirements. Those judgments reflect the desire to have enough active and reserve forces to win two nearly simultaneous major regional conflicts of approximately the scale of Operation Desert Storm. Such a goal might well

require all the units in the Administration's plan, together with "force enhancements" such as expanded prepositioning, and even then there would be few forces in reserve for additional missions such as peacekeeping or military presence.

The BUR recommends ground forces consisting of 10 active Army divisions, down from the Bush Administration's plan for 12 active divisions, and a cut of 18 percent in Army reserve personnel. Navy forces would include 11 active carrier battle groups and one more manned partly with reserves, a reduction of one fully active battle group. The Air Force would retain 13 wings of tactical aircraft (fighters) in the active component and seven in the reserves, down from a previous total of 26 wings. The Marine Corps would consist of three active and one reserve divisions, the same as its current composition. Overall, active forces in 1999 would total only about 1.4 million, nearly 200,000 below previous plans, and reserve force levels would fall by over 100,000, a slightly smaller percentage decline.

Some of the BUR's recommendations have already been adopted. Congressional supporters of Reserve and National Guard forces have indicated acceptance of the Administration's plan to scale down the reserve components. Similarly, as some in the Congress had urged, the Administration has reduced to a technology development program the effort to build a national missile defense system and shifted some of its ballistic missile defense efforts toward regional threats such as the shorter-range Scud missiles used by Iraq in the Persian Gulf War.

Defense proponents in the Congress and elsewhere argue that the BUR's recommendations go too far. They express concern that the BUR does not provide enough air- and sealift capacity to move forces between theaters as envisioned in the report. They believe that prior defense reductions have eliminated new weapon systems that the smaller forces in the BUR would need to be effective. And they decry the absence of any program that would deploy defenses against missile attacks on the U.S. mainland.

Supporters of larger cuts in military forces, however, contend that the assumptions underlying the BUR are unnecessarily pessimistic. They view the likelihood of having to fight two nearly simultaneous major regional conflicts as remote and thus question the need for forces as large as those in the Administration's plan. Smaller U.S. forces could still be substantial in comparison with those of regional powers that maintain large military forces, such as Iraq and North Korea. A smaller active force also would be large enough to meet the needs of a large regional conflict such as Operation Desert Storm if reserve forces were called to active duty as backups for other contingencies. And forces from allied nations might well be available to supplement U.S. forces, as they were in Operation Desert Storm.

Moreover, smaller U.S. forces should be adequate to handle smaller contingencies of the sort that have occurred in the past. Leaving aside Operation Desert Storm and wars for which the United States has used conscription to build up its military, the largest previous deployment of U.S. forces in combat consisted of the 22,500 troops used in Panama in 1990 for Operation Just Cause. (At its peak, Operation Restore Hope in Somalia--which was largely a peacekeeping mission, despite occasional episodes of intense combat--involved about 25,800 U.S. troops.) The military forces recommended by the BUR would far exceed those required to handle such relatively small contingencies.

Readiness

Readiness for war is another criterion used to judge military capability. During the transition to a smaller force, military readiness would probably be reduced in comparison with current levels. As additional units are eliminated, the services will have to reassign and perhaps retrain personnel and either redistribute equipment or prepare it for storage. Larger reductions would mean a greater disruption in training and readiness.

Once this transition was over, however, training and readiness probably would depend on the amount of operating funds available for a typical unit. The Congress and the Administration seem united in the belief that training and readiness need to be maintained even in a period of budget reductions, although operating funds were not exempted from

cuts in the 1994 budget. The importance placed on readiness thus suggests that training, maintenance, and other activities related to readiness should be able to continue at current levels.

Readiness also depends on the number, quality, and experience of military and civilian personnel. Unless the military services draw down their forces in a balanced manner, they might be left with more senior personnel and fewer recruits than they need. That could result in assignment mismatches, slower promotions, lower morale, and--in the long run--a shortage of midcareer commissioned and noncommissioned officers. If the overall drawdown was smaller than for some of the options discussed in this chapter, these problems might not be as severe.

Within the military services and in some quarters in the Congress, there is the belief that readiness has deteriorated from the peak of Operation Desert Storm, perhaps even to levels associated with the "hollow" forces of the late 1970s and early 1980s. Concern about this possibility led to the creation of several DoD task forces to address readiness, and a senior position was created in the Office of the Secretary of Defense to provide a focal point for readiness issues. Some indicators suggest that recent declines in readiness have been modest, at worst, and that U.S. forces are not substantially less ready than in the years before Operation Desert Storm. Nonetheless, widespread perceptions, and the fear of future declines in readiness if funding is cut further, may make it difficult to realize savings from those categories of spending tied to readiness.

Modernization

During the next decade or so, the Administration plans to equip many military units with new and expensive weapons. Additional reductions in funding for procurement would force many of these modernization plans to be abandoned or delayed significantly. Systems affected could include those in all four services and strategic as well as conventional forces.

Canceling or delaying weapon systems could adversely affect the viability of many defense contractors. Procurement budgets have already fallen sharply from levels of the 1980s. Coupled with the high prices of many new weapons, lower procurement budgets would cause the industrial base for weapons production to shrink, perhaps jeopardizing the ability of the United States to produce weapons in large quantities in the future, should that be needed.

The reductions in capability associated with slower modernization could be offset, at least for some types of forces, by making disproportionate cuts in other types of units. For example, strategic forces might be subject to larger-than-planned reductions if relations between the United States and the republics of the former Soviet Union continued to improve.

Specific Options for Reducing Defense Spending

Many of the issues touched on briefly in this introduction are discussed at greater length in connection with the specific options presented in the remainder of the chapter. Those options are grouped according to topic. Options numbered DEF-01 through DEF-20 address changes in investment plans and force structure. These options include possible reductions in funding for strategic systems, Navy ships and related systems, tactical aircraft in the Navy and Air Force, and Army units, as well as other issues related to procurement.

Options for reducing the costs of manpower, both military and civilian, and support activities are presented in DEF-21 through DEF-37. Some of these options would reduce pay, and others would change personnel policies, funding for operation and maintenance, and military medical care. Finally, options dealing with international affairs (budget function 150) are presented in DEF-38 through DEF-44.

Each of the defense options displays savings in comparison with both the CBO baseline and CBO's estimate of the Administration's plan. The text tables show total savings in the federal budget. For many options, savings in the DoD budget (budget

function 050) include accrual charges for military and civilian retirement programs. These charges result in transfers to other federal budgetary accounts and are offset in the overall federal budget, so net federal savings for these options are lower than savings in the DoD budget. DoD savings are presented in Appendix A.

The options in this chapter are neither recommendations about nor a comprehensive list of ways to reduce the defense budget. Options were included here because the Congressional Budget Office judged that they met one or more of several criteria: they had previously been the subject of Congressional debate, the need for them might be affected by recent changes in threats, or the option's efficacy was supported by analysis. Other analysts applying the same criteria might well reach different conclusions about which options to include; still others might use wholly different criteria. Moreover, the options have not been designed to be additive, so that in some cases more than one option might include the same savings.

Subject to this caution, readers might choose to combine options to meet a target for deficit reduction. Table 5 in Chapter 1 displays deficit projections that reflect defense spending according to the uncapped (inflation-adjusted) CBO baseline, as shown in Table 6. Most of the options in this chapter, however, show savings relative to both this uncapped baseline and the Administration's plan. Thus, the reader can start with either the baseline or the budget request and select from the options accordingly.

With the uncapped baseline as a starting point, constructing a deficit reduction plan is straightfor-

Table 6.
Comparison of CBO's Uncapped Baseline with the Administration's February 1994 Defense Plan
(By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	Total
			Uncapped CBO Baseline			
Budget Authority	269.0	277.6	286.0	294.8	303.9	1,431.3
Outlays	272.8	276.9	282.7	290.0	297.9	1,420.3
			CBO Estimate of Administration's Plan			
Budget Authority	263.8	255.3	252.0	258.7	265.1	1,294.9
Outlays	271.3	261.1	256.4	256.6	257.5	1,302.9
			Savings			
Budget Authority	5.2	22.3	34.0	36.1	38.8	136.4
Outlays	1.5	15.8	26.3	33.4	40.4	117.4

SOURCE: Congressional Budget Office.

NOTE: The uncapped baseline assumes that individual discretionary appropriations increase at the rate of inflation.

ward. The outlay savings from any package of options can be subtracted directly from the deficits projected in Table 5 for the uncapped baseline. The Administration, however, has proposed cuts in many defense programs. Because the baseline generally assumes continuation of programs at the real (inflation-adjusted) levels funded for 1994, the savings of a particular option are often greater relative to the baseline than to the Administration's plan. Nonetheless, adding up savings from the options shown here may not yield as much deficit reduction as the Administration's plan, which also includes many cuts in defense programs besides those discussed in this volume.

Alternatively, a reader seeking to reduce the defense budget may want to choose the Administration's plan as a starting point. That starting point would require two steps to reach a deficit reduction target. The first step would be to reduce the deficit and defense outlays under the uncapped baseline over the next five years by $117 billion (that is, the difference between the uncapped baseline and the Administration's plan, as shown in Table 6). The second step would be to select individual budget options using the outlay savings projected relative to the plan instead of relative to the baseline. Savings associated with particular options then would be added to the savings already contained in the Administration's plan to get the total amount of deficit reduction. Thus, the revised deficits (or surpluses) would be computed by subtracting from the deficits under the uncapped baseline, as shown in Table 5, both the outlay savings planned by the Administration--$117 billion--and the additional outlay savings from the package of options.

DEF-01 REDUCE NUCLEAR DELIVERY SYSTEMS WITHIN OVERALL LIMITS OF START II

	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Savings from CBO Baseline						
Budget Authority	370	710	860	1,020	1,160	4,120
Outlays	280	580	750	920	1,060	3,590
Savings from CBO Estimate of Administration's Plan						
Budget Authority	120	320	510	710	840	2,500
Outlays	80	250	420	600	750	2,100

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

With the end of the Cold War, the nuclear superpowers have begun to scale back the size of their nuclear arsenals. If put into effect, the Strategic Arms Reduction Talks (START I and START II), completed in 1991 and 1993, respectively, will require that long-range nuclear forces be cut by roughly two-thirds of their 1990 levels by early in the next century. The United States and Russia have begun to plan their nuclear forces within the framework provided by these accords; Ukraine's apparent decision of February 1994 to accede to START should aid greatly in the effort to implement these treaties.

The most recent official plan for U.S. nuclear forces, subject to revision by an ongoing Pentagon review of U.S. nuclear doctrine and forces, envisions a strategic force with 500 Minuteman III ICBMs (intercontinental ballistic missiles carrying a total of 500 warheads), up to 94 B-52H bombers (probably about 950 warheads), 20 B-2 bombers (about 320 warheads), and 18 Trident submarines (about 1,730 warheads). Overall, the strategic nuclear arsenal would reach the START II ceiling of 3,500 warheads.

This option would not reduce the number of warheads below START II levels, but instead would retire some systems the Administration plans to retain, offsetting the loss in warheads by deploying roughly twice as many warheads as planned on each Trident missile. By deploying Trident nuclear warheads more economically and in a manner consistent with START II, this option represents one approach to satisfying a goal expressed by the House Committee on Armed Services in its report on the 1994 defense authorization act.

Under this option, the United States would retire eight Trident submarines, 200 Minuteman III ICBMs, and about 50 B-52H bombers. It would deploy 300 Minuteman III ICBMs (carrying 300 warheads), 50 to 60 nuclear bombers--a combination of all the remaining B-52H and some of the B-1 fleet--each with a loading of 16 to 20 warheads (1,000 warheads), 20 B-2 bombers (320 warheads), and 10 Trident submarines, each with a near-maximum loading of 175 warheads (1,750 warheads). The total strategic nuclear force would consist of some 3,400 warheads, and no weapon system would be deployed with more warheads than it was designed for.

Air Force documents suggest that the Administration may decide to reduce the deployable B-52H force to about the level assumed in this option (roughly 40). Thus, the above table counts no savings from reductions in the bomber force. Still, this approach would save $120 million in 1995 and a total of nearly $2.5 billion from 1995 through 1999

compared with the Administration's plan. Savings would be greater in comparison with the CBO baseline, which assumes no reductions from 1994 force levels.

These savings reflect reduced operating and support costs for the forces that would be retired. (In audition, forgoing the acquisition of submarine-launched missiles would yield additional savings not included here. See DEF-02 for a discussion of Trident (D5) missiles.)

Although not reflected in the above table, the savings under this option might be partially offset by a funding increase of several tens of millions of dollars each year to improve the safety of existing U.S. forces. These funds would allow the placement of so-called permissive-action links on submarine-based missiles and accidental-destruct mechanisms on all ballistic missiles. These features, advocated by many analysts but not universally accepted or part of the Department of Defense's plans, would reduce the risk of an unauthorized launch of missiles and provide a mechanism for destroying any missiles that were launched accidentally.

During the Cold War, this option might have raised concerns about stability. By putting more nuclear "eggs" in fewer baskets, the United States would have increased--at least somewhat--its vulnerability to a surprise attack. But today, with most nuclear modernization programs in the former Soviet Union terminated, fewer weapons at high states of readiness, and geopolitical competition over, these concerns have become less acute. The United States may now decide that it can save money by deploying its warheads on a smaller number of weapon systems.

This option also would preserve flexibility for future developments. For example, it would retain three types of nuclear systems (the so-called triad), despite the suggestions of some analysts that ICBMs be retired in order to save money. This option would retain ICBMs because at least a modest fraction of them would be able to survive virtually any type of attack by any country, even if they had been taken off alert; they also provide an additional margin of security against an adversary's developing a new technology that might render one or more legs of the nuclear triad more vulnerable to attack.

Against this option's advantages, the Congress would have to balance a number of disadvantages. Carrying more warheads on individual weapons platforms would somewhat reduce the targeting flexibility of U.S. planners. Particularly on Trident submarine-launched missiles, whose number of warheads would be doubled, it also might increase the severity of any accident that resulted in dispersing toxic plutonium particles over populated areas.

DEF-02 TERMINATE PRODUCTION OF D5 MISSILES AFTER 1994

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Savings from CBO Baseline						
Budget Authority	900	700	700	1,100	1,200	4,600
Outlays	130	370	640	740	890	2,770
Savings from CBO Estimate of Administration's Plan						
Budget Authority	600	400	600	900	1,200	3,700
Outlays	80	230	420	540	760	2,030

The D5 missile (also called the Trident II missile) is the most accurate and powerful submarine-launched ballistic missile (SLBM) in the U.S. inventory. The result of more than 15 years of research and development, it is the keystone of the Navy's plan to modernize its ballistic missile force. Because of its accuracy and the size of its warheads, the D5 is the first submarine-launched missile that has a high probability of destroying counterforce targets--that is, targets such as missile silos and command bunkers that are hardened against nuclear attack. This capability will allow the Navy to assume some of the counterforce missions that previously could be carried out only by the Air Force's land-based intercontinental ballistic missiles and long-range bombers.

By 1998, the Administration will deploy a force of 18 Trident submarines. The newest 10 Trident submarines--four of which are still under construction--will be outfitted with the D5 missile. Because the D5 missile had not yet been developed, the first eight Trident submarines were originally outfitted with the older C4 missile, which is less accurate and has a shorter range than the D5. The Administration plans to procure a total of 389 D5 missiles and to install 24 of them on each of the Trident submarines that will be capable of carrying the D5. The remainder will be used for testing. The Navy has already purchased 319 missiles and plans to buy 18 more in 1995, 12 per year from 1996 through 1999, and four in 2000.

The C4 missiles are aging, and the Navy had planned to modify (backfit) the first eight Trident submarines beginning in 2001 so that they could carry the larger D5 missile. Otherwise, according to the Navy, the C4 missiles will have to undergo an expensive program to keep them in service until their submarines are retired. The Administration will not make a decision about the backfit until next year. But it has not included funds in its budget for 1995 through 1999 for either backfitting the submarines or extending the service life of the C4 missiles. Because the Navy must do one or the other and because both programs will cost roughly the same, according to the Navy, CBO has included backfit costs in its estimate of the Administration's plan.

In contrast to the Administration's plan, this option would terminate D5 production at the end of 1994 after buying 319 missiles. This option would require the Navy to make three changes to its Trident submarine force in order to reduce its requirements for D5 missiles. First, the Navy would have to terminate the backfit program and continue to deploy the C4 missile on the first eight submarines. Second, the Navy would have to undertake a new program to extend the life of the aging C4 missiles so that they could remain in the fleet until the Trident submarines carrying them were retired. Third, the Navy would have to modify the Trident submarines to carry only 12 missiles rather than the 24 missiles they were built to carry. To keep the num-

ber of U.S. warheads at the ceiling allowed by the second Strategic Arms Reduction Talks (START II) Treaty--which limits the number of warheads on submarine-launched ballistic missiles to 1,750--this option would deploy eight warheads on each missile (for a total of 1,728). In contrast, the Administration plans to comply with the treaty by reducing the number of warheads per missile from eight to four and keeping the number of missiles per submarine at 24.

Relative to the Administration's plan, this option would buy 66 fewer missiles and save $600 million in 1995 and $3.7 billion through 1999. Savings relative to the CBO baseline ($900 million in 1995 and $4.6 billion over the next five years) would be higher because the baseline, which is based on the Administration's plan for 1994, assumes that the Navy would buy 24 missiles annually through 1999. Most of the savings are attributable to reducing the number of missiles per submarine. Canceling the backfit generates only small net savings because of the added costs required to extend the life of the C4 missiles. Savings are also offset modestly (by about $1 billion) beyond 1998 by the cost of modifying the submarines to carry 12 missiles in a way that can be verified.

There are drawbacks associated with terminating D5 production. Because this option would not deploy D5s on the first eight Trident submarines, it would reduce the number of warheads on D5 missiles by 44 percent below planned levels, which would reduce the capability of the fleet to destroy some types of hardened targets. In addition, increasing the number of warheads per missile from four to eight would reduce the range of the missiles. That would decrease the areas of the ocean in which submarines could operate, thereby rendering the fleet somewhat more vulnerable. Furthermore, increasing the number of warheads per missile would reduce the targeting flexibility of the force because the Navy can cover more widely dispersed targets with four warheads on each of two missiles than with eight warheads on a single missile. Also, requiring the Navy to deploy D5 missiles with their full load of eight warheads would prevent the United States from increasing the size of its SLBM force rapidly if Russia were to break out of the START II treaty. (See Congressional Budget Office, *Rethinking the Trident Force* (July 1993), for more details about the effects of this and other options for reducing the costs of the Trident force.)

Perhaps most important, deactivating 12 missile tubes on each submarine ("detubing") would require changes to the START treaty. If the United States terminated D5 production before it could reach an agreement with the Russians to allow detubing, it would be required to deploy almost 500 warheads fewer than the Administration had planned under START II. Administration officials have expressed reluctance to enter negotiations to modify the START protocols for two reasons. First, the Administration is trying to stave off requests by Russia and other former Soviet republics to modify some of the provisions in the treaty that they find costly or onerous for other reasons. In this context, President Clinton has stated that raising the detubing issue would undermine U.S. efforts to keep the treaty intact and might even cause the START treaty to unravel. Second, Russia might try to extract some concessions from the United States that the Administration would prefer to avoid.

Nevertheless, terminating D5 production may be acceptable given the marked reduction in the chances of nuclear war between the superpowers. In this environment, the capability that would be retained under this option for Trident submarines to destroy hardened targets, which exceeds the capability that exists in today's fleet of ballistic missile submarines, may be judged sufficient to deter nuclear war. Although this option reduces the range of the missiles and the size of submarine patrol areas relative to those of the Administration's plan, they would still exceed those planned during the Cold War when Russia's antisubmarine capability was greater.

The targeting flexibility given up by this option might not significantly affect the ability of the SLBM force to deter nuclear war. It is not clear that the force of 1,728 warheads that the Administration plans to deploy on its Trident fleet under START II will deter an adversary more effectively if it is deployed on 432 rather than 216 missiles. The diminished likelihood of nuclear war with Russia may also have reduced the rationale for the United States to deploy only four warheads on each

D5 missile (which can carry eight) in order to retain its ability to increase U.S. nuclear forces rapidly. Moreover, the United States could increase the number of warheads on land-based ballistic missiles or bombers if Russia was to break out of the START II treaty.

Finally, it may be possible to address the treaty issues associated with deactivating missile tubes by making modest changes to the START protocols without formal amendments to the START treaty. If both sides are willing, they can make the changes in the Joint Compliance and Inspection Commission established to implement the treaty. Indeed, the treaty obligates the parties to try this approach first. Regardless of the approach used, Russia may agree to detubing to eliminate the significant breakout potential posed by the United States' half-loaded SLBMs. Furthermore, the Administration may be able to explore the detubing approach with Russia to see if it can be achieved without raising unreasonable requests from the former Soviet states. Alternatively, post-Cold War realities may allow some of the changes to START that these states have suggested without undermining the treaty or jeopardizing the security of the United States.

DEF-03 REDUCE DOE'S WARHEAD ACTIVITIES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	160	370	670	780	900	2,880
Outlays	110	310	580	750	870	2,620
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	160	370	680	790	920	2,920
Outlays	110	310	590	760	880	2,650

For the first four decades of the nuclear age, the United States spent billions of dollars a year to produce highly enriched uranium, plutonium, and tritium for use in weapon systems. It also employed thousands of weapons scientists to improve the ways in which warheads were designed and built, and kept over 20,000 warheads in its arsenal. By contrast, the United States now plans to keep only about 5,000 warheads in active service and is gradually working toward this goal by dismantling existing warheads and not building any new ones. It no longer produces nuclear materials (although tritium, which decays with a half-life of about 12.3 years, will need to be produced starting fairly early in the next century). Finally, the United States has adopted a restrictive policy for testing its nuclear weapons.

These steps are producing substantial savings in the defense programs accounts of the Department of Energy (DOE), which is responsible for the development, production, and maintenance of nuclear weapons and materials. Secretary of Energy O'Leary's first budget proposal anticipates that annual spending will decline to about $5.2 billion by the late 1990s, in contrast to the 1993 level of $7 billion. Even at $5.2 billion a year, however, spending on defense programs still would exceed average real levels in the 1970s, when the United States was designing new warheads and maintaining an arsenal of some 25,000 warheads. Further substantial reductions in DOE's weapons facilities, activities, and spending may therefore be possible.

This option would gradually reduce DOE's annual costs for developing, producing, and maintaining nuclear weapons and materials to about $4 billion. Savings compared with the Administration's plan and the CBO baseline would be about $160 million in fiscal year 1995 and total $2.9 billion over five years.

These savings are predicated on two broad changes in policy. First, the option assumes a permanent end to nuclear testing and related reductions in spending at nuclear research, development, and testing facilities. Further, it assumes that the future U.S. nuclear arsenal would contain no more than 3,500 warheads of all kinds combined--the maximum number of strategic warheads that can be deployed under the second Strategic Arms Reduction Talks (START II) Treaty. Weapons in storage and all tactical warheads would be eliminated. As a consequence, nuclear facilities could be built on a smaller scale.

Under this approach, one of the two main weapons design labs--either Los Alamos or Livermore--would effectively be taken out of the nuclear warhead business. Much of the spending at the Nevada Test Site would be cut, under the presumption that a permanent end to nuclear testing and a cessation in development of new types of nuclear warheads would allow for a significant scaling back of operations. No full-fledged successor to the Rocky Flats plutonium processing facility would be constructed. Plutonium pits, the spherical shells of fissionable

material used to start nuclear explosions, would be built at whichever weapons lab remained involved with warhead design--both as a way to economize and as a way to maintain the proficiency of the laboratories. At least one of the three major DOE facilities in South Carolir ennessee, and Texas would be closed. Neces unctions related to the maintenance, assembly, disassembly, and storage of nuclear warheads and materials would be consolidated at the remaining site or sites.

In an era in which stopping nuclear proliferation has become a key national security priority, the United States may find advantages to scaling back its work on nuclear warheads. Doing so would draw a clearer line between conventional weapons, which the United States sees as legitimate instruments of warfare, and nuclear weapons, which it wishes to stigmatize.

But even under this option, the United States would remain a nuclear superpower. Its arsenal would remain comparable with the likely size of Russia's and would dwarf that of any other country. U.S. forces would remain formidable, with the capability to attack large and diverse target sets in other countries, including a comprehensive range of key industrial and conventional military facilities as well as many nuclear weapons-related sites.

Moreover, under this option DOE would retain sufficient funds to sustain techniques of unsurpassed quality for "safeguarding" warheads--that is, ensuring their reliability through various computer simulations and tests on individual warhead components. These are the standard ways in which the reliability of warheads has always been tested. Actual nuclear explosions typically are used in the design of warheads rather than in their upkeep.

To avoid further nuclear testing, the United States probably would need to conclude an international comprehensive test ban (CTB). If achieved, a CTB might bolster the prospects for extending and expanding the Nuclear Non-Proliferation Treaty. This 1970 treaty, due for renewal in 1995, calls for an end to all nuclear testing. By agreeing to a CTB, the United States might improve the prospects for a strengthened nonproliferation treaty that allowed challenge inspections and a broader range of standard inspections on the territories of potential proliferators. The extent to which such a treaty would prevent proliferation is a matter of considerable debate. But with nuclear proliferation now one of the key threats to U.S. national security, pursuing all available avenues to limit it is important.

Opponents of this option might argue that a ban on testing would not allow the United States to retain complete confidence in the reliability of its nuclear deterrent or to develop new nuclear warheads designed for optimal performance and maximum safety. The Department of Energy has argued, for example, that some nuclear testing will be helpful--at least at some point in the future--in order to retain high confidence that warheads have not atrophied with age or that the addition of new and slightly different parts has not adversely affected the warheads' ability to detonate properly.

Opponents might further argue that this option would imprudently prejudge the outcome of future geopolitical trends. They might claim that a decision to scale back the design and testing of warheads and reduce the overall size of the arsenal would represent too much change too fast, coming as it would on top of the recent START process that produced major treaties in 1991 and 1993 (which have not yet been carried out). Even if military considerations eventually permit further reductions and an end to the development of new warheads, opponents of this option might urge that further changes be delayed at least until implementation of START II and a CTB has begun.

DEF-04 FOCUS THEATER MISSILE DEFENSE EFFORTS ON CORE SYSTEMS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	4,200	4,000	4,300	4,700	4,600	21,800
Outlays	1,890	3,450	4,100	4,480	4,550	18,470
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	500	500	400	700	800	2,900
Outlays	210	400	440	540	670	2,260

The Strategic Defense Initiative, which President Reagan started in 1983, focused solely on protecting the United States from a deliberate large-scale attack by Soviet ballistic missiles. The Bush Administration added an effort to protect U.S. troops and allies' civilian populations from attack by shorter-range "theater" missiles such as the Scuds used in the Persian Gulf War. The Clinton Administration--citing the urgency of the threat posed by theater ballistic missiles and the end of the Cold War--has reoriented the program to give priority to developing theater missile defenses (TMDs). It has also de-emphasized the effort to develop so-called national missile defenses, delaying indefinitely a decision to deploy defenses to protect the United States against longer-range missiles. To reflect these changes, it has renamed the effort the Ballistic Missile Defense (BMD) program. This option would make cuts in theater missile defenses beyond those proposed by the Administration.

The Administration plans to spend $17.6 billion for all BMD efforts from 1995 through 1999--an average of $3.5 billion a year. The Department of Defense would spend an average of $2.3 billion a year on TMD, $700 million a year on BMD technology efforts, $200 million a year on Brilliant Eyes (discussed below), and about $300 million a year on management and other research efforts.

Under its restructured TMD program, the Administration would deploy a "core" package that includes both point defenses (which can protect relatively small targets like airfields or command facilities) and area defenses (to protect areas a few hundred kilometers in diameter). Specifically, the Army would deploy a point defense called the Patriot Advanced Capability (PAC) 3 and an area defense called Theater High-Altitude Area Defense (THAAD). The Navy would develop a sea-based point defense based on the Standard missile that the Navy deploys on its Aegis destroyers and cruisers. To increase the area that THAAD and the Navy's area defense can protect, the Administration is developing space-based sensors, a constellation of 20 to 40 satellites called Brilliant Eyes. The Administration would also develop a battle management system to enable these TMD systems to function effectively together.

The Administration plans to develop several systems in addition to those in the core package. The Administration's plan funds an Army antiaircraft and antiballistic missile system--called Corps SAM--to protect its maneuver forces closer to the front from aircraft, cruise missiles, and short-range ballistic missiles, although much of the funding for this effort will be deferred at least until 1998. In addition, the Administration will examine the feasibility of interceptors that can destroy missiles early in their flight (during the so-called boost phase). Finally, the Administration's plan continues to help pay for Israel's effort to develop the Arrow missile as an area defense system.

Some Members of Congress have expressed concern about the cost of developing so many apparently redundant systems, including both land- and sea-based point and area defenses. Some Members also question why the United States should bear all of the cost to develop area defenses like THAAD that would be used primarily to protect the civilian populations of other nations. Other critics are concerned that the Brilliant Eyes space-based sensor proposed by the Administration would violate the terms of the Anti-Ballistic Missile (ABM) Treaty.

This option would save money by developing only the core TMD programs with the exception of Brilliant Eyes. It would develop only the Patriot and Navy point defenses, the Army's area defense, and a battle management system. The Navy area defense, the Brilliant Eyes program, and the Army's Corps SAM system would all be terminated. This option would keep all non-TMD funding at the Administration's planned level (as estimated by CBO) but would eliminate funding for boost-phase interceptors and Israel's Arrow missile.

Relative to the CBO baseline, which assumes that annual BMD funding would have remained at the 1993 planned level of $7 billion, these actions would save $4.2 billion in 1995 and nearly $22 billion over the next five years. Savings relative to the Administration's plan would be $500 million in 1995 and nearly $3 billion through 1999; these savings are lower because the Administration has already reduced average funding to only $3.5 billion a year.

Because it would cancel the Navy's area defense system, this option would reduce the flexibility of U.S. commanders during a crisis. Although sea-based defenses are limited to defending coastal regions, they can be deployed to a region quickly and do not require access to secure airfields to be airlifted into the theater--a limitation of land-based systems like THAAD. The United States can also deploy sea-based defenses without having to obtain basing rights in another country, a process that could cause domestic political difficulties for some friendly governments. This option would preserve the capability to defend small areas such as ports or amphibious landings from the sea. But without the Navy's sea-based area defense system, the United States would not be able to defend larger areas such as cities until THAAD could be deployed. Nor could it use forward-based ships to defend large areas of Europe or Japan against attack from the Middle East or North Korea, respectively.

Changes under this option would also limit the area that could be defended by the remaining systems. Canceling Brilliant Eyes would limit the area that THAAD could defend because ground-based and airborne sensors would take longer to detect incoming missiles, thereby reducing the range at which those missiles could be intercepted. These effects may be made more severe by the recent decision by the Department of Defense to cancel the Follow-on Early Warning Satellite, which might have provided some of those capabilities. Canceling Brilliant Eyes could also affect the capability of a future national missile defense system, if the United States eventually chooses to deploy one. In addition, terminating boost-phase interceptor programs would halt work on systems that have the potential to be effective against missiles armed with nuclear or chemical warheads if technical problems can be overcome. Finally, cutting off funding for Israel's Arrow area defense missile would jeopardize a critical program for one of the United States' closest allies, which currently faces a real ballistic missile threat.

Notwithstanding these disadvantages, under this option the United States would still deploy capable land- and sea-based point defenses, a land-based area defense, and a battle management system, all according to the schedule proposed by the Administration. By eliminating all TMD funding beyond the core systems, this option would halt several programs early in their development phase. In addition to the savings between 1995 and 1999, these actions could save significant sums beyond 1999, when the noncore programs and Brilliant Eyes would have entered full-scale development and production. (At current and projected budget levels, procurement funds may never be available for many of these systems.) This option would also eliminate payments to Israel to support development of the Arrow missile. In this period of tight budgets, it

may be inappropriate to spend U.S. funds for development of a foreign system that the United States has no intention of buying.

In addition to lowering costs, canceling Brilliant Eyes would eliminate the concerns of some critics that the sensors--by effectively substituting for ABM radars--would violate the ABM treaty. The contractor building THAAD has stated that the capability of its system does not depend critically on Brilliant Eyes and that such sensors are needed only to defend the large areas required for national missile defenses. Since the Administration has delayed indefinitely a decision to deploy national missile defenses, space-based sensors such as Brilliant Eyes may not be required for many years, if at all.

DEF-05 TERMINATE PRODUCTION OF THE TITAN IV

	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Savings from CBO Baseline			
Budget Authority	600	800	900	1,000	1,100	4,400
Outlays	210	430	620	800	920	2,980
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	100	300	500	700	1,100	2,700
Outlays	30	120	230	400	650	1,430

The Titan IV is the United States' only unmanned launch vehicle capable of carrying large satellites into orbit. The Air Force started developing Titan IV in 1985 to ensure that it had the capability to launch large payloads without using the space shuttle. These efforts intensified after the Challenger disaster in 1986. Today, the Department of Defense is completely independent of the shuttle for its heavy-lift needs.

The Air Force currently relies on Titan IV to launch satellites that provide early-warning and certain types of communications. The Air Force also launches classified satellites on Titan IV for intelligence agencies to provide photoreconnaissance, radar imaging, signal intelligence, and ocean surveillance. (All information contained in this discussion is based on unclassified data from the Air Force and published reports.) Through the end of 1994, the Congress has authorized 41 launchers. Seven of the 41 have been launched successfully; an eighth Titan IV failed shortly after launch.

The Air Force plans to purchase eight more Titan IVs through 1999 to fulfill its requirements and those of the intelligence agencies. Beyond 1999, the Air Force will not purchase any more Titan IVs for its own needs, but it plans to purchase two per year indefinitely to meet the projected demand for classified payloads. Air Force data indicate that DoD would probably have to launch an average of four to five Titan IVs per year through 2000 and about two per year thereafter in order to deploy and sustain all of the satellite constellations that it currently maintains or plans to deploy.

Titan IV is a very expensive launcher. When purchased and launched at the average rate of two per year planned by the Administration, they are projected to cost $230 million to $320 million per launch depending on how the rocket is configured. For comparison, the average cost of a shuttle launch is around $300 million. (Although accounting differences make it difficult to compare these costs directly, they should still illustrate the rough costs of each launcher.) DoD has developed an upper stage called Centaur that will allow Titan IV to lift larger payloads into orbit, which adds to the cost of the program, and is also upgrading the Titan IV solid rocket boosters to improve their reliability and capability.

Under this option, the Air Force would terminate production of Titan IV beyond 1994, after purchasing 41 launchers. The option offers the potential for sizable savings in the long run, although its short-term savings would be more modest. Compared with CBO estimates of the Administration's plan, terminating production of Titan IV would yield a net savings of $100 million in 1995 and nearly $2.7 billion through 1999. Relative to the CBO baseline, which keeps funding constant at the authorized level for 1994 after adjusting for inflation, net savings would be higher ($600 million in 1995 and $4.4 billion through 1999). Savings through 1999 would result from halting procurement

of Titan IV; beyond 1999, savings would be partially offset by the cost of buying alternative launch vehicles and redesigning payloads. Finally, in the middle of the next decade when Titan IV launches are halted, savings would increase after the United States shut down the facilities required to launch Titans.

In the long run, this option assumes that DoD will redesign its large satellites by 2006 so that they can be launched on smaller rockets such as Atlas medium-lift vehicles. In some cases, DoD could use the shuttle or foreign launchers to orbit heavier payloads. The Air Force already plans to stop launching payloads requiring heavy-lift vehicles by the middle of the next decade. However, other agencies plan to continue to launch large payloads on Titan indefinitely.

To allow time for redesign, the option assumes that DoD would continue to use the 33 remaining launchers for large payloads but at a slightly lower rate than planned by the Administration. The United States could reduce the launch rate by limiting the number of satellites it keeps in orbit. For example, the end of the Cold War may have reduced the number of imaging satellites that the United States needs to cover potential trouble spots adequately. The need for ocean surveillance satellites may also have diminished because the threat of a large-scale war at sea has eased: Russia's navy is deteriorating in port, and no other country has a large fleet capable of operating in the open ocean. The Air Force may also be able to deploy smaller versions of its last four MILSTAR satellites, as suggested in a recent paper by RAND. Furthermore, many satellites reportedly have been lasting longer in orbit than planned, thereby reducing the need to launch replacements.

Yet this option makes sense only if the United States can eliminate its long-term requirement for Titan IVs by the middle of the next decade. It could achieve that goal in several ways. Using new technologies such as adaptive optics, the United States may be able to reduce the size of its imaging payloads without sacrificing their ability to see small objects on the earth (a quality called resolution). By changing requirements, the United States may also be able to reduce the size of its payloads. For example, DoD recently canceled the planned replacement for the Defense Support Program's early-warning satellite (the Follow-on Early Warning Satellite, or FEWS) and now plans to deploy a less capable version of FEWS that would be small enough to be launched by a medium-lift rocket. DoD may also be able to reduce the weight and size of satellites by eliminating some of the systems that were intended to increase satellites' survivability during the Cold War. For example, it could eliminate laser cross-links and reduce the amount of rocket fuel kept on board each satellite for evading Soviet antisatellite weapons.

The United States could also move away from Titan IV by reducing the resolution that it requires from its imaging satellites. Current photoreconnaissance satellites have high resolution (reportedly on the order of inches) and survey the entire Earth. Yet the United States may be able to relax those requirements--especially over northern latitudes--because the Soviet Union is no longer an adversary. For example, the United States could deploy its high-resolution satellites on the shuttle into inclined orbits (say, between 57 degrees north and south latitude). Those orbits would increase coverage over the nonpolar regions of the globe, which encompass virtually all of the world's unstable regions and likely U.S. adversaries. To ensure global coverage, the United States could use medium-lift vehicles to deploy satellites with coarser resolution in polar orbits (perhaps even one of the commercial satellites with one-meter resolution that have recently been proposed).

Finally, the United States could eliminate its requirements for Titan IV by launching its heavy intelligence payloads on foreign launchers such as the Russian Proton or the French Ariane V. Reports indicate that these launchers are significantly less expensive than Titan.

Although this option promises substantial savings, it has several significant drawbacks. The principal disadvantage is that if redesign efforts failed, terminating Titan IV production after 1994 could seriously limit the United States' ability to launch, in the next decade, those intelligence satellites that cannot be made smaller or lighter. Unexpected technical problems or higher-than-expected

costs during redesign could prevent DoD from reducing the weight of these satellites by the time it uses its last Titan IV. If so, it might have to deploy satellites with less capability or shorter service lives. Reducing the amount of rocket fuel on board satellites could also shorten service lives, and eliminating cross-links could increase operating costs.

If DoD is unable to reduce the size of all of its payloads, it might have to rely on the shuttle or foreign launchers. But the shuttle cannot deploy those satellites that require polar orbits; nor can it lift into distant geosynchronous orbits payloads as large as Titan IV with its Centaur upper stage. Legislation also discourages using the shuttle if unmanned alternatives are available. Thus, without Titan IV the United States might have to use foreign launchers for those large payloads that cannot be launched by the shuttle. Such a course could risk divulging secrets or having an unreliable supply of launchers if the international situation changed.

DEF-06 REDUCE THE NUMBER OF AIRCRAFT CARRIERS AND AIR WINGS TO 10

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	3,920	640	1,050	1,490	1,540	8,640
Outlays	240	730	1,460	1,880	2,020	6,330
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	2,760	640	850	1,080	1,120	6,450
Outlays	230	660	1,130	1,360	1,450	4,830

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The aircraft carrier is the centerpiece of the U.S. Navy. In 1994, the Navy will have a fleet of 12 carriers and 11 active and two reserve air wings--the numbers that the CBO baseline assumes will be maintained through 1999. The Administration's plan also calls for a fleet of 12 carriers in 1999 (11 active plus one carrier, manned partly by reserves, that could also be used for training) with 10 active air wings and one in the reserves to provide combat capability for these ships. The carriers would be accompanied by a mix of surface combat ships--usually cruisers and destroyers--and submarines that can attack planes, ships, and submarines that threaten the carrier. These surface combatants and submarines can also attack targets on land.

Some policymakers have argued that the United States does not need a force of 12 carriers in the aftermath of the Cold War. Such a fleet would contribute substantially to U.S. tactical air power, but even after the reductions proposed by the Administration, the total capability of all U.S. tactical aircraft in the Navy and Air Force would substantially exceed that of any regional power that seems potentially hostile. Further cuts may therefore be acceptable.

Moreover, the capabilities of U.S. ships are unsurpassed worldwide. The Navy has ships other than carriers, including large amphibious vessels, that can assist in maintaining a U.S. naval presence overseas in peacetime. Perhaps for these reasons, some policymakers have contemplated carrier force levels below those recommended by the Administration's plan. In 1990, before the breakup of the Soviet Union, the Chairman of the Senate Committee on Armed Services recommended a force of 10 to 12 carriers. And during the 1992 campaign, President Clinton called for a Navy with 10 carriers.

This alternative would retire two conventionally powered carriers early so that by 1999 the Navy would have 10 carriers (nine active carriers and one manned partly by reserves that could also be used for training). In addition, from the force of 10 active and one reserve air wings, it would eliminate one active air wing and leave nine active air wings and one reserve wing to match the number of carriers. The alternative would also cancel additional funding for the next planned new carrier, the CVN-76, because the Navy, with a smaller force, would not need to replace retiring carriers in the near term. In fact, with a 10-carrier force, the Navy would not need to replace a retiring carrier until after the turn of the century.

Compared with the CBO baseline, which has 12 carriers and 13 air wings, savings could total about \$3.9 billion in 1995 and roughly \$8.6 billion over the next five years. Total savings estimates include about \$3.6 billion in 1995 from canceling the next planned carrier. Compared with the Administra-

tion's plan, which CBO estimates will have 12 carriers and 11 air wings, savings could be $2.8 billion in 1995 and $6.5 billion over the 1995-1999 period. The total savings estimates include about $2.5 billion requested for the CVN-76 in 1995. (Savings from the Administration's plan are so much lower than savings from the CBO baseline because the Administration apparently hopes to receive approval to reprogram over $1 billion in 1994 from the National Defense Sealift Fund for the purchase of this ship. The budget, however, does not contain this reprogramming request.) Costs to decommission the retiring ships would offset some of these savings, but CBO does not have the data to estimate their magnitude. Additional procurement savings, also not included in the savings shown above, might be realized. For example, the Navy might not need to buy as many DDG-51 destroyers for the smaller fleet (see DEF-09 for a discussion of the DDG-51). Also, the cut in air wings would reduce the number of required aircraft (see DEF-12 for a discussion of changes in procurement of naval aircraft).

According to former Secretary of Defense Les Aspin, reducing the force to 10 carriers would not impair the ability of the U.S. military to fight and win two regional wars that start nearly simultaneously. He has argued, however, that having fewer ships would limit the Navy's ability to keep three carriers deployed overseas most of the time.

It may be possible, however, to maintain deployments with a smaller fleet. In peacetime, some carriers spend time in repair; others are kept at U.S. ports to provide stateside duty time for their crews; still others are in transit to their operating stations. The Navy argues that only one-quarter or less of the carrier fleet can be deployed overseas in peacetime. Thus, a reduction to a fleet of only 10 carriers might mean that, much of the time, one carrier fewer on average could be deployed overseas compared with the level under the Administration's plan.

But the factors the Navy used throughout the 1980s implied that about a third of the carrier fleet would be deployed overseas. Moreover, the Navy kept five carriers overseas out of a fleet of 13 ships in the late 1970s. That experience suggests that the fraction of the carrier fleet that might operate overseas routinely is larger than the Navy's current formula would suggest, although according to the Navy such intensive use of carriers led to a number of problems.

Furthermore, a reduced overseas presence may be acceptable in the post-Cold War world. The United States would still have at least two carriers deployed overseas at any one time, and possibly more if the Navy deployed a larger fraction of its carrier fleet. However, some missions, such as those requiring substantial numbers of fixed-wing aircraft, can be performed only by carriers. In a crisis requiring such capability, a smaller force might mean an increase in the time before U.S. combat capability became available.

Alternatively, the Navy could use surface combatants other than the carriers to maintain a naval presence in peacetime and to assist in responding to crises. For example, it could use groups of ships centered around the 11 planned large amphibious assault ships that are designed to transport Marines and their equipment; these ships can embark helicopters and Harriers (Marine Corps attack aircraft that can land and take off vertically) and are as large as the aircraft carriers of many other countries. These Amphibious Ready Groups are fully capable of handling some missions usually performed by carriers, such as limited strikes and the evacuation of noncombat personnel.

The Navy may also be able to meet some of its deployment requirements with groups of surface combatants that do not include any kind of carrier. These formations have been made possible because the offensive capabilities of surface combatants have been augmented with the Tomahawk missile for attacking targets hundreds of miles inland and because their defensive capabilities have been enhanced by the Aegis system for defense against attacks from aircraft and antiship missiles. With the demise of the Soviet Union, a substantially reduced threat to U.S. ships also contributes to the feasibility of maintaining a presence with ships other than carriers.

There are disadvantages to this option. If peacetime deployments required of carriers continue

at current levels but the Navy has fewer vessels available, the time that ships spend at sea would have to increase. That would mean that the high-quality sailors the Navy needs would be spending more time away from their homes and families, thus making it harder for the Navy to retain them.

In addition, under this option the Navy would not build another nuclear-powered carrier until after the turn of the century. Since the carrier now under construction is likely to be completed in 1998, much of the carrier industrial base might be shut down. According to a report released by DoD, restarting it would cost $2.1 billion in the years beyond 1999; these additional costs include restarting the shipbuilder's production facilities after closing them down in the intervening years, retraining the workers, and requalifying the manufacturers of components. The report notes, however, that increases in costs might also be constrained by careful planning before the shutdown to minimize the cost and effort of restarting production. Alternatively, the report states that the increased costs and risk to the shipbuilder could be minimized by keeping the shipyard open through rescheduling ship overhauls, the delivery of carriers already being built, and other work.

DEF-07 TERMINATE PRODUCTION OF SEAWOLF SUBMARINES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	-330	0	0	0	0	-330
Outlays	-260	-60	-10	0	0	-330
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	-330	1,550	0	0	0	1,220
Outlays	-260	60	390	360	350	900

The SSN-21 (Seawolf class) submarine was designed to counter projected improvements in Soviet submarines. Like the SSN-688 (Los Angeles class) submarine that it follows, the Seawolf's mission is to detect and destroy enemy submarines and surface ships and to launch cruise missiles against targets on land. According to the Navy, the Seawolf would have many advantages over the SSN-688, including the ability to dive deeper, carry more weapons, and operate more quietly at higher speeds. In addition, it would have advanced sensors for detecting enemy submarines and a more powerful computer system to coordinate sensors and weapons.

Although the Congress had previously approved the purchase of three Seawolf submarines, by 1992 a combination of budgetary pressures and the end of the Cold War led the Bush Administration to propose canceling the last two vessels and terminating all future Seawolf procurement and research. The Congress, however, decided to restore funding for a second of the three submarines, and the Clinton Administration subsequently expressed its support for producing a third Seawolf (designated the SSN-23).

The Administration acknowledges that the SSN-23 is not needed to meet military requirements. Rather, it will be purchased to keep open a second shipyard capable of producing nuclear submarines. The two yards eventually will compete to build the New Attack Submarine, designed to be a lower-cost successor to the Seawolf. The New Attack Submarine is scheduled to be purchased beginning in 1998.

Canceling plans to buy the SSN-23 would save \$1.2 billion in budget authority during the 1995-1999 period compared with the Administration's plan. (There would be no savings from the CBO baseline, which does not include production of the third Seawolf.) Although the Navy expects the SSN-23 to cost \$2.5 billion, the Congress has already appropriated about \$920 million that could be used to purchase the ship. Of the \$920 million, about \$380 million was appropriated for advanced procurement for the ship's combat system and components of the nuclear reactor; the remaining \$540 million was appropriated to support the submarine industrial base and could be used to help pay for a third Seawolf. The Navy would incur about \$330 million in additional expenses to close down one of the two shipyards that produce submarines. (CBO assumed that these costs would be incurred in 1995.) The \$2.5 billion cost for the third Seawolf minus the \$920 million already appropriated and the approximately \$330 million in additional costs to close down a shipyard leaves about \$1.2 billion in savings.

The need for U.S. attack submarines has declined sharply because of the greatly diminished threat from submarines of the former Soviet Union. Because the Navy now needs to purchase fewer submarines, a seven-year gap in production will exist between authorization of the second Seawolf

(1991) and the scheduled authorization date for the New Attack Submarine (1998). Without new orders for submarines during this period, General Dynamics' Electric Boat shipyard--one of the two U.S. facilities that produce nuclear-powered submarines--would probably go out of business. The survival of Tenneco's Newport News Shipbuilding, the other producer of submarines and also nuclear-powered aircraft carriers, is not in jeopardy, although that yard also might lose the capability to build submarines.

Proponents of the SSN-23 contend that it would maintain the industrial base of submarine subcontractors until the New Attack Submarine is built. For example, the manufacture of periscopes may be put at some risk during a gap in production. Buying the SSN-23, however, would not greatly affect maintenance of the industrial base for components used in nuclear propulsion, because most of the funds for the submarine's reactor have already been appropriated for advanced procurement.

Seawolf supporters also argue that if there is insufficient work to keep its industrial base operating, the Navy would probably experience higher costs and longer procurement times to reconstitute these capabilities in the future. According to one Navy official, most industrial capabilities can be reconstituted, but at a higher cost in both time and money. According to an analysis done for the Department of Defense, a hiatus in submarine production would engender additional costs and delays associated with reassembling and retraining some of the work force needed to produce submarines, unless workers were retained on the payroll during the gap in production. If production was delayed indefinitely, the skills to produce submarines or their components and systems eventually might be lost.

One main argument for buying the SSN-23 from Electric Boat is that keeping that yard in business would ensure competition for future submarine contracts, thus saving money. But the costs of buying another Seawolf and thus keeping Electric Boat open could more than offset savings from future competition. Such savings might not be that great because the small number of submarines that would be produced would probably allow competition to be maintained only in the design of the ship. And even if only one shipyard survived, the Navy would still remain its principal customer and as such might be able to control costs.

Maintaining the industrial base, moreover, may not require producing additional submarines. For example, in its report on the 1994 defense appropriation bill, the House Committee on Appropriations notes that less expensive alternatives may be available to provide work for the industrial base. One alternative is overhauling older 688-class submarines and modernizing them to the improved 688-class standard. The Navy currently has no estimate of the cost of overhauling and modernizing 688-class submarines, but it has been asked by the House Committee on Appropriations to make one. Funding for these activities might come from the previous appropriation of $540 million.

Overhauling and modernizing 688-class submarines might not provide sufficient manhours of work to maintain the current submarine industrial base, and some types of work (and workers) might be excluded. For example, the skills needed to form submarine hulls would not be needed to overhaul and modernize existing hulls. But according to the analyst who did the study for DoD, overhauling and modernizing 688-class submarines would exercise most of the skills required to sustain the industrial base and would therefore lower the costs to reconstitute industrial capabilities in the future.

DEF-08 ELIMINATE FRIGATES FROM THE NAVAL FORCE

	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
	Savings from CBO Baseline					
Budget Authority	110	340	580	840	1,120	2,990
Outlays	80	260	480	720	990	2,530
	Savings from CBO Estimate of Administration's Plan					
Budget Authority	80	240	410	590	760	2,080
Outlays	60	180	340	510	680	1,770

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

In addition to aircraft carriers, the primary surface combatants of the U.S. Navy are cruisers, destroyers, and frigates. Cruisers and destroyers often form part of a carrier battle group, escorting and protecting the carrier. Destroyers and frigates can escort the ships of an Amphibious Ready Group, which carries Marine troops and equipment. Frigates also can escort both the Underway Replenishment Groups that resupply naval forces and the convoys of merchant ships that resupply troops fighting in a foreign theater. According to one Navy official, under the Administration's plan the U.S. Navy projects that it will need 126 cruisers, destroyers, and frigates in its inventory in 1999--116 surface combatants in the active forces and 10 frigates in the reserve forces. Although this number of surface combatants constitutes a significant reduction from about 150 under the Bush Administration's proposed "base force," further reductions are possible.

The Navy's current inventory includes 51 Oliver Hazard Perry class frigates (FFG-7s). For the Navy to reach its goal of 126 surface combatants by 1999, CBO projects that the Navy will have to retire early 17 of the 51 frigates.

This option would reduce the number of surface combatants by retiring early an additional 34 FFG-7s, leaving 92 surface ships in the inventory by 1999. Twenty-four of these 34 FFG-7s would be retired from the active forces and 10 from the Naval Reserve forces. Reductions would be carried out in equal increments from 1995 through 1999. Compared with the CBO baseline, which has 51 FFG-7s, savings could total about $110 million in 1995 and roughly $3 billion over the next five years. Compared with the Administration's plan, which according to CBO estimates will have 34 FFG-7s by 1999, savings could be $80 million in 1995 and about $2 billion over the 1995-1999 period.

Retiring the 34 additional Perry class frigates would remove this class of ships from the Navy's inventory. Retiring an entire class of ships can substantially reduce expenses for logistics and spare parts. Cutting the number of surface combatants might also permit a cut in the number of combat logistics ships and, hence, in their associated operating and support costs. These potential savings, however, are not included in this option. Some of the savings in this option would be offset by costs to decommission these ships, but those costs would probably be small.

With the dissolution of the Soviet Union, the threats facing Navy ships from enemy aircraft and submarines operating in the open ocean have greatly diminished. The most likely opponents the United States would face in a regional war generally have only modest naval assets and no heavy bombers that could attack U.S. ships at long ranges. The United States may be able to counter these threats even

while substantially reducing the number of surface combatants.

Moreover, the FFG-7 frigates, which specialize in antisubmarine warfare, are the Navy's smallest and least capable surface combatants. Because the submarines of the former Soviet Union have become less of a threat and war in Europe has become much less likely, the United States may no longer need frigates to escort convoys of war supplies. In addition, because submarines now pose less of a threat to Amphibious Ready Groups and Underway Replenishment Groups in transit to carrier battle groups, fewer surface combatants may be needed as escorts.

Under this option, however, the Navy would have fewer surface combatants to deploy independent of battle groups or during regional conflicts. Such ships might be useful to conduct naval quarantines, such as those imposed on Haiti and nations of the former Yugoslavia. This reduced capability could also be of concern in the unlikely event that two or more regional wars occurred nearly simultaneously and involved regional powers that had significantly increased their naval capability--for example, by buying submarines or other ships from Russia. In addition, by retiring the frigates, the Navy would lose some of its antisubmarine warfare capability. Given the significant decline in the threat from submarines of the former Soviet Union, however, this reduced capability might be acceptable.

DEF-09 REDUCE PROCUREMENT OF DDG-51 DESTROYERS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	510	1,440	1,360	710	1,400	5,420
Outlays	40	240	590	860	970	2,700
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	900	940	950	970	1,010	4,770
Outlays	70	300	520	740	820	2,450

The DDG-51 destroyers of the Arleigh Burke class would be used in a war to protect aircraft carrier battle groups and to attack land- and sea-based targets. The ships incorporate the Aegis combat system, which is designed to protect aircraft carrier battle groups from attacks by enemy aircraft and antiship missiles fired from them. Compared with previous classes of destroyers, the DDG-51s incorporate other improvements in speed, weapons, and armor. The Navy states that the DDG-51s also will be more difficult for enemy forces to detect because of design features that reduce their radar, sonar, and infrared signatures. To date, the Congress has funded 29 of the DDG-51s. The Administration plans to buy 15 more DDG-51s--three per year from 1995 through 1999.

This option would buy only 10 DDG-51s from 1995 through 1999 at a rate of two a year. Compared with the CBO baseline, this option could save about $500 million in 1995 and $5.4 billion over the next five years. The CBO baseline is consistent with last year's budget request and includes 18 DDG-51s at a total cost of about $14.7 billion, or roughly $820 million each. Compared with CBO's estimate of the Administration's plan, which would buy 15 DDG-51s at a total cost of about $14.3 billion or $950 million each, savings could be $900 million in 1995 and nearly $4.8 billion through 1999. The smaller fleet of DDG-51s in the next decade would also result in savings in operating and support costs that are not included in this option.

Reducing the number of DDG-51s purchased per year could have some disadvantages. Buying fewer DDG-51s might reduce the capabilities of the fleet by providing fewer ships that can perform multiple missions (such as strike and anti-air, antisurface, and antisubmarine warfare). With the Navy's post-Cold War policy of deploying its ships more flexibly, which could require that surface combatants sometimes be deployed without an aircraft carrier, such capabilities might be more important.

Moreover, proponents of the Administration's plan might contend that the advanced capabilities of the DDG-51s will continue to be needed in the post-Cold War world. The sophisticated combat systems that the DDG-51 incorporates include the Aegis system for air defense, designed to stop attacks by large numbers of enemy aircraft and their antiship missiles attempting to saturate the air defenses of the aircraft carrier battle group. The hostile air threat to the U.S. Navy has declined with the breakup of the Soviet Union, and smaller air forces of regional powers that the United States is most likely to fight are less capable of launching saturation attacks. Combat against regional powers, however, is likely to bring ships into littoral areas where they would have less time to react to threats and thus might benefit from the quicker reaction of the Aegis system.

Only two shipyards currently build surface combatants, and reducing procurement to two vessels a year might sustain only one producer. The shipbuilding industrial base has declined markedly over the past decade, and the Congress would have to weigh carefully the possible effects of further reductions to the country's naval shipbuilding capabilities and the ability to reconstitute them if a change in threat required a buildup of forces.

In addition, savings from reducing purchases could be smaller than estimated under this option if the unit cost per ship rose because overhead was spread over fewer units produced. If reduced purchases caused one shipyard to close, the remaining shipyard might be able to charge higher prices that might offset some or all of the savings from lower production. In addition, if the remaining shipyard had to finish building ships that the closing shipyard had begun, the unit costs of those ships might rise. The government, however, might be able to arrange for the closing shipyard to finish ships under construction before going out of business.

The Navy may be able to minimize such growth in unit costs. Even if only one shipyard remained, the government--a single buyer that has many alternative uses for its limited procurement budget--might be able to exert pressure on that yard to restrain costs. Indeed, one approach that the Navy might take would be to let the two shipyards bid competitively for a single contract covering all 10 ships purchased during the 1995-1999 period. The size of such a contract would guarantee competitive bidding.

A reduction in the number of DDG-51s, as proposed in this option, need not limit the Navy's ability to counter regional threats. For example, the combination and automation of sensor inputs and weapons in non-Aegis ships may allow them to react faster to the shorter-range threats in regional conflicts. Advances in communications may allow a ship with an advanced Aegis system to control the weapons of all other ships in a group, shortening the reaction time of the entire group.

With the 66 Aegis ships that would eventually be available under this option (27 authorized CG-47 Ticonderoga class cruisers, 29 authorized DDG-51s, and 10 future DDG-51s), two could be assigned as escorts to each of the 12 aircraft carrier battle groups, leaving 42 available for independent operations. In addition, the Navy would need fewer Aegis ships to escort carrier battle groups if the number of carriers was reduced (see DEF-06) or if lower threat levels warranted assigning only one Aegis ship per battle group. Because of the reduced threat, the Navy is lowering the number of surface combatants assigned to escort and protect the aircraft carrier.

Even with the slower rate of construction in this option, the Navy could meet its goal for surface combat ships. Under the Administration's plan, the Navy will seek to maintain a smaller force of about 110 to 116 active surface combatants (cruisers, destroyers, and frigates). The Navy is now retiring ships before the end of their service lives to make resources available to buy the DDG-51s. To reduce the rate of procurement of the DDG-51 and still meet the goal of 110 to 116 ships, the Navy would have to allow some ships that it scheduled to retire early to serve out their useful service lives.

DEF-10 REDUCE AIR FORCE TACTICAL FORCES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Savings from CBO Baseline						
Budget Authority	170	900	1,500	1,550	1,600	5,720
Outlays	120	680	1,240	1,420	1,520	4,980
Savings from CBO Estimate of Administration's Plan						
Budget Authority	120	660	1,100	1,140	1,180	4,200
Outlays	90	500	910	1,040	1,120	3,660

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The military forces proposed by the Administration include 20 tactical air wings--13 active and seven in the part-time reserves--six fewer than the Bush Administration planned to have. (Traditionally, an Air Force tactical air wing has consisted of 72 combat aircraft, plus about 28 aircraft for training and .naintenance, though the service may be revising this concept.) There is substantial disagreement about whether all of these forces are needed, since U.S. tactical aircraft enjoy overwhelming superiority compared with the forces of those regional powers that appear potentially hostile to the United States. Perhaps for this reason, former Secretary of Defense Les Aspin, when he was the Chairman of the House Committee on Armed Services, recommended in 1992 that the Air Force retain only 18 tactical wings--10 active and eight reserve.

This alternative would follow that recommendation and further reduce the tactical fighter forces in the Air Force to 18 wings by the end of 1995. So rapid a schedule for reductions should be feasible inasmuch as the Air Force has reduced the size of its fleet quickly in the past; for example, it eliminated six wings during 1991 and 1992. Moreover, most of the six additional wings the Clinton Administration plans to eliminate will be cut by 1995. Reducing the number of Air Force wings to 18 would cut the service's operating costs by $120 million in 1995 and by almost $4.2 billion through 1999 in comparison with CBO's estimate of the Administration's plan. (Savings from the CBO baseline, which funds operations at 24 wings--the level requested in 1994--would be higher, at $170 million in 1995 and $5.7 billion for the period from 1995 through 1999.) Additional savings might accrue from reductions in the procurement of aircraft, but those savings are not included in the table above. (See DEF-11 for a discussion of changes in procurement of Air Force tactical aircraft.)

In addition to achieving savings, a reduction to 18 Air Force wings could still leave the United States with an acceptable level of military capability in a post-Cold War world. "Balance and Affordability of the Fighter and Attack Aircraft Fleets of the Department of Defense," an April 1992 CBO analysis of several potential adversaries (North Korea, postwar Iraq, and Cuba), found that even after reducing the number of tactical air wings to 26 as proposed by the Bush Administration, the capability of the tactical aircraft in the Air Force exceeded that of the other countries by factors of 22, 24, and 56, respectively. (The analysis was based on a scoring system developed for the Department of Defense.) The large margin of superiority suggests that additional reductions may be feasible without sacrificing the U.S. advantage.

Retaining only 18 wings in the Air Force, however, would not meet the military's current estimate of its requirements. Analysis by the Department of

Defense suggests that 20 wings would be the minimum needed to win in two nearly simultaneous regional conflicts. Today's U.S. force planning assumes that the United States needs to be able to fight virtually simultaneous wars in two regions of the world--one in the Middle East and another perhaps in Asia. If one accepts this requirement, then the Air Force may well need more than 18 wings.

Some analysts would also argue that additional cuts in Air Force wings ignore a major lesson from the war with Iraq: aerial bombardment by tactical aircraft can be quite effective and may greatly accelerate the end of a war, thus reducing the loss of lives among U.S. ground troops. A sizable inventory of tactical aircraft, perhaps more than would be maintained under this option, may therefore be a wise investment.

DEF-11 CANCEL THE AIR FORCE'S F-22 AIRCRAFT PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Savings from CBO Baseline and CBO Estimate of Administration's Plan						
Budget Authority	2,460	2,370	2,510	2,120	2,860	12,320
Outlays	1,140	2,030	1,900	1,660	1,710	8,440

The F-22 aircraft is being developed as the Air Force's next premier fighter and is scheduled to begin replacing the F-15 aircraft around 2000. Fighter aircraft are designed primarily to destroy enemy planes, thus guaranteeing the United States and its allies control of the air. The Air Force wants the F-22 aircraft to have supersonic cruise speed as well as stealth characteristics that make it difficult for enemy sensors to detect. The F-22 aircraft would also be designed to fly long distances and to have highly effective avionics that could make it more capable than other fighters in many types of combat. The F-22 entered full-scale development in 1991, and the first F-22s are to be bought in 1997, according to the Administration's plan.

This option would cancel the F-22 program on the grounds that its additional capability may be both unnecessary and too expensive. Compared with the Administration's plan and the CBO baseline, canceling the F-22 would save almost $2.5 billion in 1995 and $12.3 billion for the 1995-1999 period. The total estimated savings include procurement, research and development, and military construction.

The high cost of the F-22 is one argument for canceling it. The Air Force planned to buy 648 aircraft last year at a total cost of about $71.3 billion in 1994 dollars ($86.6 billion in current dollars). The average unit procurement cost of the F-22 would have been about $81 million in 1994 dollars--about 75 percent more than that of the F-15 aircraft in 1991, the last year that fighter was in production. Now the Air Force seems likely to buy no more than 442. The unit procurement cost of the F-22 would probably rise as a result of this reduction in total quantity, but CBO has not yet received new estimates of the program's cost from the Department of Defense.

Since the costs of many weapon systems increase during the full-scale development phase that the F-22 entered in 1991, actual costs could be even higher. For example, the F-22's cost could rise if the Air Force has to fix design flaws. The Air Force argues that the April 1992 crash of the only flying prototype of the F-22 was caused by the way the aircraft was operated and that certain operating restrictions or at most minor software changes should prevent future problems, but such mishaps may portend costly production problems. Some recent press reports also suggest that the F-22 may be experiencing other development problems, such as increases in weight, that can raise its costs. And unit costs will rise if F-22 procurement is reduced even further below planned levels.

Events in the Persian Gulf suggest that current Air Force aircraft are able to counter any threat less severe than that formerly posed by the Soviet Union, which many analysts consider to have been the only hostile country whose air force had the capability to threaten U.S. fighters. In view of that reduced threat, the F-22 may provide more capability to attack enemy fighters than the United States needs.

Moreover, other types of aircraft may prove to be more useful in future conflicts. The extensive use of tactical bombing in the Persian Gulf War emphasizes the value of aircraft that can attack land targets, perhaps in preference to aircraft such as the F-22, which is designed to combat enemy fighters.

Given the changes in the nature of the threat, strategies other than buying expensive F-22 aircraft might better meet the Air Force's future needs. Such strategies might include upgrading existing aircraft or developing a new plane that is less capable but cheaper than the F-22.

Nor does the Air Force need to buy the F-22 any time soon to support the reduced size of its tactical forces. CBO's analysis suggests that even if the Air Force procured no fighter aircraft after 1993, it would have more than enough aircraft to support the currently planned force of 20 tactical wings through at least the middle of the next decade. (This analysis assumes that the Air Force does not retire aircraft in current inventories before their service lives expire. If the Air Force retires a number of planes early--as it may be planning--it may have to buy new planes sooner to maintain inventory levels. The Air Force will also increase its need for new planes if it uses fighters as sources of spare parts rather than buying new spares, as it may do with portions of its bomber fleet.)

The Air Force contends that the improved capabilities of the F-22 aircraft would be required even in a world in which U.S. tactical air forces are smaller and the former Soviet threat is much reduced. If the United States canceled the F-22 program, the capability of its fighters through the first decade of the next century would be similar to that of today's F-15 aircraft, which entered development in the 1960s. By the next decade, regional powers such as Iraq may possess fighter aircraft that are at least the equal of the F-15. Thus, to maintain its edge, the Air Force believes that the United States needs the improved capability the F-22 aircraft offers. The Air Force also raises concerns about escalating threats from the ground that may degrade the survivability of current aircraft. Surface-to-air missiles are cheaper and easier to operate than fighter aircraft and may be more accessible to regional powers. To counter these threats, fighters may need the improved capabilities of the F-22, including stealth and higher speed.

In addition to its value as a fighter aircraft, the F-22 may offer some capability in the ground attack mission. DoD has recently announced its intention to provide the F-22 with some ground attack capabilities. The plan to add this ability to attack targets on the ground may be the Administration's response to criticisms that the F-22 is less useful in regional conflicts if it is a pure fighter aircraft. The F-22's capability to attack targets on the ground may be modest, however, according to some press reports. And the F-22's ability as a bomber will undoubtedly be less than that of a plane developed primarily for the bombing mission.

DEF-12 CANCEL THE UPGRADE OF THE NAVY'S F/A-18 FIGHTER

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
	Savings from CBO Baseline and CBO Estimate of Administration's Plan					
Budget Authority	1,350	970	2,000	2,340	2,360	9,020
Outlays	740	830	800	1,170	1,710	5,250

For the foreseeable future, the F/A-18 aircraft will account for the bulk of the Navy's fleet of carrier-based aircraft that perform fighter and attack missions. The F/A-18 attacks targets both in the air (the fighter mission) and at sea or on the ground (the attack mission). The current version of the F/A-18 is designated the C/D model.

In 1991, the Navy announced plans to develop a new E/F variant of the F/A-18. The E/F version features several modifications: a longer fuselage, a larger wing, and a more powerful engine than are now on the C/D version. These changes should enable the E/F version to carry a larger load of weapons than the C/D version, or to carry the same load about 50 percent farther. Both attributes are important factors in determining the plane's capability in the attack role. The new engine should also enable the heavier E/F aircraft to retain the speed and maneuverability of the earlier version, important performance considerations in fighter combat.

Though more capable, the E/F version will also be more expensive than the C/D model--about 40 percent more by some estimates--and the Navy will have to pay about $2.6 billion from 1995 through 1999 to develop the plane. This option would cancel development and procurement of the new E/F model and instead would buy sufficient additional C/D aircraft to maintain the Administration's planned production rates. Compared with both the CBO baseline and CBO's estimate of the Administration's plan, savings would total $1.4 billion in 1995 and $9.0 billion over five years. Savings from canceling the upgrade might be even larger if the F/A-18 experiences unanticipated cost increases.

The requirement for an upgraded F/A-18 aircraft may be questionable in view of today's reduced military threat. The threat to carrier battle groups stemmed largely from the former Soviet Union, and the possibility of conflict with the former Soviet republics now seems increasingly remote. Regional powers are not likely to be able to match the capability of current U.S. fighters for many years. But if the enhanced fighter capabilities offered by the E/F version are not needed, neither may be its added attack capabilities, based on the Navy's judgments about other systems. The Navy plans to retire its venerable but longer-range A-6 fleet in 1997 and has canceled development of a new longer-range replacement, the A/FX, at least in part because the service now places less emphasis on deep strike and more on supporting Marine forces that operate at relatively short ranges from the ships that transport and support them. And even if the added capabilities of the E/F model are needed, trends in the F/A-18 program suggest that they may be hard to achieve. Some critics of the program have noted that the A/B model of the F/A-18 attained only about 75 percent of the originally specified goal for the fighter's range, and the C/D model achieved only about 70 percent of the original specification.

Canceling the E/F development program would have some disadvantages. Even in conflicts with smaller nations, improvements in the F/A-18's range, if they materialize, might be useful in the attack mission; indeed, critics of the C/D version believe its relatively short range limits its usefulness. Moreover, now that the A/FX has been canceled, the E/F upgrade will be the only major upgrade the Navy will purchase for its fighter fleet for at least 10 years.

DEF-13 CANCEL THE MARINE CORPS'S V-22 AIRCRAFT PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	380	40	-100	-120	-200	0
Outlays	230	230	70	-50	-130	350
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	450	570	1,090	1,050	1,010	4,170
Outlays	270	520	600	680	750	2,820

The V-22, a new plane entering procurement in the late 1990s, is intended to help the Marine Corps perform its amphibious assault mission of seizing a beachhead in hostile territory and its subsequent operations ashore. V-22s will transport up to 24 Marines or 10,000 pounds of their equipment, moving either from amphibious ships to the shore or from one shore base to another. The plane employs a "tilt-rotor" technology that enables it to take off and land vertically like a helicopter and, by tilting its rotor assemblies into a horizontal position, become a propeller-driven airplane when in forward flight. The V-22 will be able to fly faster than conventional helicopters; it will also fly longer distances without refueling and thus can "self-deploy" rather than being carried to distant theaters on planes or ships, the common mode of transport for conventional helicopters. The Marine Corps also argues that analysis shows the V-22's increased speed and other characteristics of its design will make it less vulnerable when flying over enemy terrain.

Despite all of these advantages, the Bush Administration tried to cancel the plane, largely because of its expense. At a projected unit cost of about $45 million, the V-22 costs considerably more than conventional helicopters. Notwithstanding the V-22's high cost, the Congress has continued to fund it, and the Clinton Administration's 1995 budget request contains funds to continue development and begin procurement. The Marine Corps plans to procure a total of 425 V-22s. Another 50 planes might eventually be bought for special operations forces, and the Navy plans to buy 50 for combat search-and-rescue missions and for logistics support of its fleet.

At present, the Marines use helicopters to transport personnel and equipment in amphibious missions. One helicopter--the CH-53E, which carries heavier loads than the V-22 and costs about 60 percent as much to procure--will continue to transport Marine equipment even after the V-22 is fielded. The Marines will continue to need some CH-53Es to meet requirements for lifting heavier equipment, but the Administration plans to cancel procurement of the helicopters in 1995.

This option would cancel the V-22 and continue procurement of CH-53Es. It would buy six CH-53Es per year from 1995 through 1999, half the number bought in 1994. Relative to CBO's estimate of the Administration's plan, the option would save about $450 million in 1995 and $4.2 billion over five years. Compared with the CBO baseline, the option would save nearly $400 million in 1995, but net savings for the 1995-1999 period would be zero. The CBO baseline, which reflects last year's budget request, includes funds for development but no money for procurement. The cost of buying six CH-53Es annually from 1995 through 1999 completely offsets these development costs.

In addition to saving money, buying CH-53Es might entail less risk than developing a V-22. Two of five V-22 prototypes have crashed, as has one of two XV-15 aircraft built to demonstrate tilt-rotor technology. The Marine Corps argues that the problems that caused these crashes have already been remedied without substantial design changes. But the crashes may suggest problems with the design. If there are problems, developers may need to increase the already high costs of the plane or reduce its capability. Indeed, if some press reports are accurate, the V-22's capabilities may already be eroding. These recent reports imply that the plane is overweight, resulting in reductions in its payload and range, though the plane is apparently still expected to meet the Department of Defense's specifications.

The Marines Corps argues that the CH-53E does not meet its requirements for the amphibious assault mission for a number of reasons. First, the slower CH-53E is less likely than the V-22 to survive in hostile environments. Second, even if the V-22 is purchased, CH-53Es will be needed to transport heavy items of equipment that the V-22 cannot carry, but Marine Corps doctrine dictates that the first assault wave be delivered by a more survivable aircraft than the CH-53E. Furthermore, Marine Corps personnel suggest that CH-53Es might not be able to build up sufficient forces fast enough to stop enemy troops who might arrive soon after operations begin. Smaller U.S. forces would increase the likelihood of a U.S. defeat or potentially increase the number of casualties. This problem of building up forces quickly might be at least partially overcome if each CH-53E carried more troops, but the Marine Corps argues that CH-53Es are too unwieldy and vulnerable to carry large troop loads.

Finally, Marine Corps personnel argue that the CH-53E, or indeed any other current helicopter, would be unacceptable because it cannot deploy overseas without substantial assistance and risk. Many current helicopters can make the relatively long trips over water required to deploy in the Pacific, but they must refuel in flight, requiring the assistance of tanker aircraft, and their slower speed increases the chance that pilot fatigue will result in missing a tanker rendezvous or cause other mishaps.

DEF-14 REDUCE THE NUMBER OF ARMY LIGHT DIVISIONS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
	Savings from CBO Baseline					
Budget Authority	370	1,240	2,710	4,280	5,290	13,890
Outlays	310	1,070	2,400	3,890	4,930	12,600
	Savings from CBO Estimate of Administration's Plan					
Budget Authority	460	1,580	2,780	3,710	4,180	12,710
Outlays	380	1,360	2,490	3,410	3,940	11,580

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

As of early 1994, the active portion of the U.S. Army consisted of 14 divisions, eight of which are generally regarded as "heavy"--that is, equipped with tanks and other armored vehicles. The eight heavy divisions are primarily intended to be used against other armored forces. The other six divisions, referred to as "light" divisions, are useful against less heavily armored forces and were designed to be dispatched quickly and transported easily to trouble spots around the world. They include one airborne division, one air assault division, and four light infantry divisions (LIDs). The Administration plans to eliminate two LIDs by the end of 1994 and two heavy divisions during the next five years.

The utility of the light infantry divisions has been questioned in the Congress and elsewhere since their creation nine years ago. The Reagan Administration justified the LIDs by emphasizing the need to respond to events anywhere in the world by rapidly dispatching U.S. forces. But recent history indicates that the United States may not need these divisions. Between 1945 and 1978, 215 incidents required some sort of U.S. military action, but only about 5 percent of them required a force of division size or larger. One can argue that other units--including the Army's airborne and air assault forces and three Marine Corps divisions--provide sufficient rapid response.

Other questions arise about the capability of the LIDs once they have been transported, presumably to a hostile location. With 870 jeeps, 135 motorcycles, and 41 utility helicopters for transportation, a light infantry division has limited mobility, and most of its 10,000 to 11,000 soldiers would have to move by foot. A LID also has limited firepower, particularly against an enemy with any kind of armored vehicles. Each division has only 44 long-range antiarmor missiles, 62 howitzers, and 29 armed helicopters; the most numerous antiarmor weapon in the LID--162 Dragon medium-range antitank missiles--has limited capability against modern tanks.

Perhaps the strongest statement about the utility of the LIDs in combat was made by the Department of Defense when it failed to use any light infantry forces during Operation Desert Storm. That conflict was initiated by a relatively unsophisticated foe and occurred halfway around the world with very little warning. The need to establish some military presence in theater very rapidly would seemingly have argued for the use of light infantry forces. Nevertheless, none of the LIDs were deployed. Another telling experience has been that of the 10th Mountain Division--a light infantry division--in Somalia. The division's firepower and protection proved to be inadequate against even the unsophisticated and poorly equipped troops of a Somali warlord. As a

result, parts of a heavy division were dispatched to Somalia to provide armored protection to U.S. forces there.

Questions could also be raised about the Army's need for both an airborne and an air assault division. The former is designed to be dropped by parachute into hostile territory when no seaport or airport is available for debarkation; the latter is designed to be deployed by helicopter to relatively remote locations, although the deployment must be staged from a protected area. The United States has not conducted a parachute assault involving an entire division since World War II. Drops including one brigade--about one-third of a division--were carried out in Korea and Vietnam and in Panama in 1990. In Operation Desert Storm, portions of the 82nd Airborne were sent to the Middle East early in the operation, but they did not parachute in and, once reinforced by later-arriving heavy combat units, were assigned supporting roles and were not involved in any major battles. Additional paratroop-qualified units exist in the special forces branch of the Army, and it is not obvious that the Army needs an entire division designed to be dropped by parachute.

This alternative would eliminate all but one of the remaining light divisions from the Army's active forces. Forces disbanded would include all of the remaining light infantry divisions and portions of the airborne and air assault divisions. To permit an orderly drawdown, one division would be eliminated each year, starting in 1995. The alternative would retain one airborne division consisting of two air assault brigades and one airborne brigade. Starting from the CBO baseline, which is based on an Army that includes six light divisions in 1994, this alternative would eliminate five light divisions over the next five years, saving $370 million in 1995 and almost $14 billion over the next five years. Compared with CBO's estimate of the Administration's plan, which includes only four light divisions in the Army in 1994, this alternative would eliminate three light divisions over the next five years and save slightly less than $13 billion for the same period.

Despite these savings and the shortcomings of the light infantry divisions, eliminating them would reduce U.S. capability in certain situations. For example, LIDs might be useful during combat in urban areas where armored vehicles cannot operate easily. LIDs might also be useful for defending areas such as airports or seaports if the enemy did not have armored capability. A proposal to eliminate all of the LIDs might also encounter political opposition because it would mean closing some military facilities that have been activated and refurbished in recent years.

DEF-15 CANCEL THE ARMY'S TANK UPGRADE PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	120	220	90	-80	190	540
Outlays	20	60	130	120	20	350
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	150	520	390	480	530	2,070
Outlays	10	80	270	370	400	1,130

The shrinking of the U.S. military, coupled with the disappearance of a long-time foe and the unprecedented peacetime investment in modern weapons that occurred in the 1980s, has sharply reduced the need for new weapons. In particular, the Army now has enough of the latest type of tank, the Abrams, to equip the forces it plans to have for the foreseeable future, and so has no plans to buy new tanks for at least the next 15 years.

The Army has proposed instead to upgrade about 1,000 M1s--the first model of the Abrams tank--to a later configuration designated as the M1A2. This program is intended, in part, to increase the capability of some of the tanks that the Army will have in the field for the next 20 years and in part to keep producers of tanks and tank parts in business, pending the need for a tank to replace the Abrams.

During the Bush Administration, the Army advocated closing the tank production line and putting it in mothballs. In March 1992, then Chairman of the Joint Chiefs of Staff General Colin Powell testified before the Congress that the Army's current tank is the best in the world. That testimony disputes the Army's current rationale for upgrading tanks, which is based on the need for better ones. Indeed, although the M1A2 is 20 percent more capable than the M1 model--as measured by one scoring system developed for the Defense Department--converting 1,000 M1 tanks to the M1A2 model would increase the total capability of the 7,880 Abrams tanks in the Army's inventory by only 3 percent. This slight increase in capability would come at a high price--a total of almost $2.3 billion over the next five years.

This alternative would cancel the Army's upgrade program but would retain the components of the tank industrial base in a mothballed status. Mothballing the government-owned facilities that manufacture tanks and components could cost nearly $400 million over the next five years. By preserving the facilities, however, the United States would retain the capability to produce tanks again when the next generation is needed to replace the Abrams or in the event of a crisis that would require more Abrams tanks. Compared with the CBO baseline, savings from adopting this alternative would amount to about $120 million in 1995 and would total $540 million over five years. Compared with CBO's estimate of the Administration's plan, savings would be $150 million in 1995 and about $2.1 billion from 1995 through 1999.

Closing the tank line would also have some disadvantages. Without an upgrade program, the U.S. inventory would include almost none of the most capable M1A2 tanks. As regional powers acquire improved tanks, the absence of M1A2s might erode the U.S. advantage in a war, even though the M1A1 remains a highly capable tank. Closing the tank line would also end U.S. capability to produce new tanks quickly. The Army estimates that producing a new M1A2 tank from a mothballed

line could take more than four years--one year more than to produce a new tank from a line involved in modifying tanks.

Perhaps the most important drawback of this option is that some businesses that currently manufacture tank components might close and so be unavailable to produce tanks in the event of a crisis. A related concern is the potential loss of workers whose skills are unique to tank manufacture and who would have to be retrained in order to perform up to government standards. Even though Defense Department officials have asserted that the United States currently has enough capable tanks to meet any foreseeable contingency and that there would be enough time in the event of a major crisis to restart the tank line, shutting the tank line down completely carr[illegible]ks. These risks have to be weighed ag[illegible]undreds of millions of dollars that would need to be spent annually to provide insurance against them.

DEF-16 CANCEL THE ARMY'S RAH-66 PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	220	100	30	160	360	870
Outlays	210	230	110	130	220	900
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	300	140	260	280	410	1,390
Outlays	260	280	260	280	300	1,380

The Army fields about 6,500 helicopters, some of which are approaching the end of their expected 20 years of service life or have exceeded it. About 3,000 of the helicopters, the OH-58 Kiowa scout helicopters and the AH-1 Cobra attack helicopters, are Vietnam-era aircraft that the Army is anxious to replace with the RAH-66 Comanche helicopter. The Comanche will fill both the reconnaissance and attack roles that these two helicopters now perform.

The Comanche program, when it was conceived in 1983, was intended to develop one aircraft that, in two different configurations, could replace not only the Vietnam-era scout and attack helicopters described above but also the UH-1 utility helicopters of the same vintage. The Army originally planned to buy over 5,000 Comanches of various configurations. The utility version was dropped in 1988, however, because the program had become too costly; since then, the program has included only the attack and scout version, and the quantity has been reduced further, from a planned purchase of over 2,000 aircraft to just under 1,300 helicopters. The helicopter is still in the development stage, which will continue at least through 1999. The Army, which as recently as 1992 had planned to start buying Comanches in 1996, has since delayed the start of procurement until at least 2000.

As a consequence of changes in the objective and size of the program, the cost of each Comanche helicopter has increased substantially since the program began. In constant 1993 dollars, the cost for each Comanche has grown by a factor of two, from $10 million in 1985 to $20 million in 1992, and the Comanche has become more expensive to acquire than the Army's current generation of attack helicopter, the AH-64 Apache, which is bigger and heavier than the Comanche. This growth is significant, particularly in a helicopter whose development was originally justified on the basis of its being inexpensive to purchase, operate, and maintain. Indeed, the Comanche's high cost calls into question the prudence of pursuing this yet undeveloped aircraft instead of continuing to buy existing helicopters such as the AH-64 or later models of the OH-58.

The General Accounting Office (GAO) has questioned the wisdom of continuing the Comanche program. A report published in 1992 noted not only the increase in the cost to acquire the Comanche but also the potential for increases in the maintenance costs to three times the original estimates. These factors, plus the risk of additional cost increases as technical issues are resolved, caused GAO to question the Army's underlying rationale for the Comanche program. In addition, the Comanche, which was conceived at the height of the Cold War, will no longer need to counter threats of the same scale or sophistication as those it was designed to thwart. Indeed, the Comanche is now so similar in capability to the Apache, the aircraft it is supposedly designed to complement, that it is unclear what unique role it would play in Army aviation. Without a mission that existing Army

helicopters cannot perform, it is hard to justify the continued development of an aircraft that is more expensive to acquire than existing helicopters.

Based on these various concerns, this alternative would provide other means for filling the Comanche's role, at reduced cost. It would cancel the RAH-66 program, thereby saving $2.6 billion over the next five years. Some added costs would be associated, however, with buying more helicopters of other types. The Army has already purchased enough Apaches to fulfill the attack role assigned to eight of its 12 divisions. During Operation Desert Storm, Apaches performed their missions without scout helicopters, and this alternative accordingly provides no replacements for the aging OH-58s currently assigned that role in those divisions. The Army, however, needs to replace the aging AH-1s assigned to the attack aviation units of its remaining divisions. Armed scout helicopters, known as armed OH-58Ds, were used effectively in the Persian Gulf and could replace the AH-1s still in service. The Congress has supported purchase of these aircraft in the past, and the Army has proposed a program to field a limited number (315) of these helicopters over the next few years. This alternative would buy 36 armed scout helicopters each year, leading to a total procurement of 495 helicopters through 1999. After taking into account the cost of buying these helicopters, net savings compared with the CBO baseline would be $220 million in 1995 and would total $870 million over the 1995-1999 period. Compared with CBO's estimate of the Administration's plan, net savings would be $300 million in 1995 and almost $1.4 billion through 1999.

The disadvantage of adopting this alternative would be the loss of new aviation technology incorporated in the Comanche. Some analysts would argue that the threats the Comanche is likely to face would not demand the very sophisticated stealth, avionics, and aeronautic technologies slated for the new helicopter, but others would support the program as a way to maintain the U.S. lead in helicopter technology. Some of the Comanche's new technologies already are being incorporated into current U.S. helicopters such as the Apache. Abandoning the RAH-66 program, however, would mean that the Army would have to rely on helicopters designed in the 1960s and 1970s for years to come.

DEF-17 CANCEL THE C-17 AIRCRAFT AND BUY COMMERCIAL AIRLIFTERS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Savings from CBO Baseline						
Budget Authority	2,300	3,220	3,090	3,160	3,910	15,680
Outlays	120	670	1,680	2,430	2,840	7,740
Savings from CBO Estimate of Administration's Plan						
Budget Authority	1,940	1,910	-350	0	-20	3,480
Outlays	160	570	1,100	960	400	3,190

The C-17 is a four-engine transport aircraft that can carry a cargo payload of at least 110,000 pounds for a distance of 3,200 nautical miles without aerial refueling. It is being produced as the next-generation airlift aircraft to replace the C-141 Starlifter. Because it is designed to land at relatively small airfields with short runways, the C-17 also is expected to play an important role in meeting transport needs within a combat theater and will substitute for other aircraft, such as the C-130, that traditionally perform that role.

Twenty-six C-17 aircraft have already been authorized through 1994, and after an intensive review of its airlift options, the Administration recently announced that it will commit to purchasing only 14 more planes. The Administration holds out the possibility of additional purchases if the C-17's producer, McDonnell Douglas, lowers the aircraft's costs and reduces its manufacturing defects. Alternatively, the Air Force may rely on a mix of fewer C-17s and new C-5B aircraft or wide-body commercial jets for its core airlift capability.

This option would cancel the Administration's plan to buy 14 more C-17 aircraft and instead would purchase 12 wide-body commercial aircraft such as the Boeing 747-400F or the McDonnell Douglas MD-11 freighter. These purchases would provide the Air Force with roughly the same amount of airlift capability, as measured in millions of ton-miles per day. Relative to CBO's estimate of the Administration's plan, savings could be $1.9 billion in 1995 and nearly $3.5 billion over the 1995-1999 period. (These estimates use Boeing 747-400F prices.) Virtually all of these savings, which are net of the cost of buying 12 commercial aircraft and their support equipment, would be realized in 1995 and 1996, when, according to the Administration's plan, the 14 C-17s are scheduled to be bought.

CBO's baseline is generally consistent with last year's budget request, which supported purchasing a total of 120 C-17s--66 of which would be bought over the 1995-1999 period. Savings relative to the CBO baseline therefore appear much larger: about $2.3 billion in 1995 and nearly $16 billion over the five-year period. Readers should use these figures with caution, however, since the ultimate size of the C-17 program is uncertain, and relative to the CBO baseline, the purchase of 12 commercial aircraft would not provide the Air Force with equivalent airlift capability.

The option would minimize purchases of an aircraft that, among other problems, has had difficulty meeting its performance goals. As part of a settlement reached in January 1994, the Defense Department plans to lower se[illegible] specifications for the amount of weight the [illegible] must be able to carry, the plane's landing dist[illegible] while carrying its maximum payload, and the amount of heavy equipment it can air-drop. Air Force officials claim that the original C-17 contract specifications were based on transportation goals set during the Cold War,

which are now unnecessary. But some analysts contend the C-17 will have trouble meeting even these lower performance thresholds.

Manufacturing quality has also been of concern. For example, in October 1992, the wing of the C-17 test aircraft buckled under a test load equal to 124 percent of maximum operating weight. Specifications for the C-17 contract require that the aircraft be able to withstand 1.5 times the structural stress it is expected to encounter during a lifetime of normal use. More recent wing tests have been controversial as well: the left wing failed in two areas as it neared or soon after it reached the 150 percent goal.

Costs for the C-17 program have risen dramatically. If one excludes changes in costs caused by updated assumptions about inflation and the number of aircraft to be purchased, cost estimates for the C-17 have increased nearly $19 billion, or 47 percent, from the original plan. Last year, the Air Force estimated that the total unit cost for each C-17 would be about $330 million if 120 planes are purchased. That cost is likely to rise if the Air Force buys fewer aircraft.

Opponents of this option would argue that at a time when the U.S. military is preparing to face diverse regional conflicts on short notice, the Air Force needs more of the versatile C-17 airlifters. Civilian wide-body jets can deliver bulk cargo very efficiently, but they cannot carry "outsize" cargo such as an M1 tank or an Apache helicopter. Canceling the C-17 program at 26 aircraft therefore might limit the speed with which the United States could carry out some military missions. The C-17 is also designed to be able to survive enemy attacks better than existing military or commercial airlifters; it is expected to be more maneuverable and better able to detect and avoid missiles and antiaircraft artillery.

In addition, commercial planes are ill suited for austere environments and require long runways and special equipment to be loaded or unloaded. Without the C-17, limitations on the availability or capacity of large international airports might restrict the ability of the United States to deploy forces. This issue may be especially important given the Administration's stated goal of being able to deploy enough forces to fight and win two major regional conflicts nearly simultaneously.

Finally, this option could eventually reduce airlift capability below current levels. Today's fleet of dedicated military airlifters has a capacity of 35 million ton-miles per day. But the workhorse of the current fleet, the C-141, is reaching the end of its service life. After conducting some inspections in early 1993, the Air Force limited the majority of its Starlifters to loads of 55,000 pounds (about 14,000 pounds less than normal maximum loads) and grounded 45 planes because of small cracks emanating from weep holes in the planes' wings. As of January 1994, 114 out of 244 aircraft were in maintenance depots awaiting repair work. The Air Force expects that all but 42 of the Starlifters will be repaired by March 1994, and the entire fleet should be restored to unrestricted flight by December 1994. If other structural problems emerge, however, the Air Force may have to accelerate its retirement schedule for the aircraft. Replacing this lost capacity would require the purchase of additional C-17s or commercial airlifters, which would reduce savings under this option.

DEF-18 RETIRE EXCESS KC-135 TANKERS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
	Savings from CBO Baseline and CBO Estimate of Administration's Plan					
Budget Authority	40	110	190	280	370	990
Outlays	30	90	170	250	340	880

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The U.S. Air Force owns a large fleet of aircraft to refuel transports, fighters, and bombers while they are airborne. Being able to do so is important for tactical air operations and for deployment of forces by air from the United States to other parts of the world. Currently, U.S. tanker forces consist of 489 KC-135 aircraft and 57 KC-10 aircraft (both figures are in terms of primary aircraft authorized).

During the past several years, most of the aircraft in the KC-135 fleet have been retrofitted with new CFM-56 engines that increased their thrust and fuel-carrying capacity. Over two-thirds of the KC-135 fleet has been or will be modernized with this engine by 1995. The remainder (designated as KC-135E aircraft) have been retrofitted with less efficient engines for the Air Reserve and Air National Guard.

The Air Force plans to retire approximately 20 KC-135s by 1997. This option would retire another 100 E-version aircraft--those with the least efficient engine technology and the smallest capacity for fuel delivery--at a rate of 20 planes per year through 1999. That would still leave the military with nearly 425 tanker aircraft (including KC-10s). Compared with the CBO baseline and the Administration's plan, this approach could save about $40 million in 1995 and nearly $1 billion through 1999.

Historically, the tanker fleet has played an important role in the nuclear deterrence mission by supporting long-range strategic bombers. Today, however, most of the requirements for aerial refueling are derived from regional threats. The tanker fleet provides an "air bridge" for deploying conventional forces, reducing the amount of time it takes to place U.S. forces in distant theaters and decreasing the degree to which the United States must rely on staging bases abroad. Tankers can be used to refuel airlift aircraft, as was done recently to support the C-5 aircraft that carried heavy equipment into Somalia. To a limited extent, KC-135s can also transport cargo. *Once in theater, tanker aircraft* support fighters and bombers, increasing their combat range and endurance. For example, about 300 tanker aircraft supported operations in the Persian Gulf War.

This option could provide enough tanker capacity to meet the requirements of future regional contingencies. The combination of planned KC-135 retirements and the changes in this option would amount to less than a 25 percent reduction in the Air Force's total capacity for fuel delivery by 1999 compared with its current level. In terms of numbers of aircraft, these reductions are commensurate with the Administration's plans to reduce the number of Air Force fighter wings by nearly 30 percent below the current level.

Retiring more of the older KC-135E aircraft would also avoid other problems. The KC-135E has a refurbished engine used formerly by Boeing 707 aircraft in commercial service. Although this engine has greater fuel efficiency than the KC-135's original engine, it gives the aircraft less capacity for fuel delivery and slightly higher operating and support costs than aircraft equipped with the more modern CFM-56 engine. In addition, the older

engine does not comply with Federal Aviation Administration Stage III noise standards set for the year 2000. Since tankers often operate out of airfields used for both military and commercial aircraft, the Air Force would probably have to purchase "hush kits" or put new engines in its E-version planes in the near future.

Retirement of KC-135E tankers, however, might reduce the number of KC-10 aircraft available for airlift tasks. In addition to being an aerial refueling aircraft, the KC-10 can be used as an airlifter; it is especially efficient at delivering bulk cargo. The Air Force plans to dedicate just 19 of its 57 KC-10s to air refueling missions, leaving the remainder free primarily for cargo delivery. By retiring more of the Air Force's aircraft dedicated to refueling, this option may reduce the number of KC-10s that can be devoted to airlift missions.

Moreover, the Air Force may need to rely on aerial refueling more heavily if the United States loses access to foreign bases that support airlift missions en route. During the Gulf War, three bases (Zaragoza, Torrejon, and Rhein-Main) handled 61 percent of the airlift traffic. Of these bases, one is no longer available and it is questionable whether the United States will have the same degree of access to the others in the future. Opponents of this option might argue that a large tanker fleet makes the United States less dependent on obtaining overflight and landing rights.

This option might leave the United States unable to wage a conventional war and a major nuclear war involving strategic bombers at the same time. However, in light of the low probability of nuclear war and the availability of other platforms for delivering nuclear weapons that do not depend on tankers (particularly missiles based on submarines), this loss of capability is unlikely to be a problem.

Perhaps more important, this option might also limit the United States' ability to achieve the Administration's stated goal of being able to prosecute two major regional conflicts that occur nearly simultaneously. In the Persian Gulf War, the military deployed 46 KC-10 and 262 KC-135 tankers. The refueling aircraft retained under this option would be sufficient for a future deployment of similar size and would also provide capability for a simultaneous, smaller conventional deployment in some other theater or for support of a small nuclear mission. But such a force would not permit the United States to fight two simultaneous wars on the scale of Operation Desert Storm.

DEF-19 PHASE OUT SPENDING ON SEMATECH AND THE TECHNOLOGY REINVESTMENT PROJECT

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Savings from CBO Baseline						
Budget Authority	120	240	370	510	650	1,890
Outlays	50	160	280	410	550	1,450
Savings from CBO Estimate of Administration's Plan						
Budget Authority	270	390	500	650	740	2,550
Outlays	130	290	410	540	660	2,030

The Department of Defense's Advanced Research Projects Agency (ARPA) has played an expanded role in sponsoring research and development (R&D) in dual-use technologies--those that have both civil and military applications. Some Members of Congress and the Administration endorse this role in order to bolster economic growth in certain high-technology industries and help defense contractors to diversify into commercial markets. Two dual-use programs that ARPA supports are SEMATECH, a consortium of private companies that develops semiconductor manufacturing technology, and the Technology Reinvestment Project (TRP), a program that provides support to consortia that develop or disseminate dual-use technologies. The Congress appropriated a total of $564 million for these programs for 1994, and the Administration, given its commitment to technology policy and the Congress's interest in the programs, supports continued funding.

This option would keep federal support for SEMATECH and TRP at its 1994 appropriation level and then phase it out by cumulative increments of 20 percent per year between 1995 and 1998, eliminating funding by 1999. The effects of the defense drawdown on the U.S. economy should have declined significantly by the end of the decade, and a sunset provision for SEMATECH and TRP may help focus efforts on a limited number of achievable research objectives. Relative to the CBO baseline, which assumes no real growth from 1994 funding levels, savings would be $120 million in 1995 and nearly $1.9 billion over the five-year period. Compared with the Administration's plan, in which funding for TRP grows from $625 million in 1995 to $725 million by 1999, phasing out these programs could save $270 million in 1995 and nearly $2.6 billion through 1999.

Phasing out SEMATECH's funding could be justified on several grounds. The consortium has already achieved many of its original technical objectives, such as developing process tools to make integrated circuits with device widths of 0.35 micron. SEMATECH has set follow-on objectives, but it is not clear how well these technical goals suit Department of Defense needs; ARPA has proposed in the past that it fund only those SEMATECH projects that the agency selects on the basis of merit.

Even if federal support for SEMATECH continues, the consortium may not be able to sustain some domestic suppliers of semiconductor manufacturing equipment. For example, with the help of SEMATECH, GCA Corporation--one of the few U.S. producers of photolithography machinery--increased the technical sophistication of its equipment. But sales prospects dropped off and GCA closed its business; the company's assets were auctioned off in December 1993. SEMATECH also cannot control whether companies that develop technology with its help share those innovations

with foreign firms, even though such sharing may undermine the objectives of the program.

Perhaps for these reasons, in 1992 ARPA proposed that federal funding be phased out and that private industry assume full responsibility for SEMATECH. For 1994, DoD officials indicated that consortium members were willing to contribute only $90 million, and the Congress reduced its matching appropriation accordingly.

Because the Technology Reinvestment Project is a newer and more diverse program, justifications for phasing it out are somewhat different from those for SEMATECH. The TRP collectively refers to a number of DoD programs designed to help integrate the military and civilian sectors of the U.S. economy. ARPA and five other federal agencies are awarding funds on a competitive cost-sharing basis to groups of private companies, research organizations, and educational institutions that develop or disseminate dual-use technologies. Most of the funding for 1993 had been allocated to 162 project proposals by December 1993, and the Congress appropriated another $474 million for TRP in 1994. The Administration hopes to reprogram another $120 million out of DoD's 1994 budget and include the $30 million MARITECH maritime technology program in the TRP award process. That would raise TRP's available funds to $624 million--the level at which it was authorized.

TRP awards are unlikely to create enough new jobs in the near term to reduce substantially the layoffs that will take place because of cutbacks in defense spending. Under the Administration's proposal, 1999 defense budget authority would be about $29 billion lower than its 1994 level (measured in 1995 dollars). Even if its funding rose to more than $700 million annually, TRP would counterbalance only a small fraction of job losses in the defense sector. R&D projects sponsored by TRP may improve overall productivity in the economy, but any effects on job creation are likely to be long term, perhaps taking a decade or longer.

Moreover, SEMATECH and TRP sponsor a type of R&D for which the grounds for government funding are less clear. Most economists believe that federal support for basic R&D is justified because the private sector will underinvest in research of that type. More contentious, however, is the degree to which the government should support applied R&D, the type funded by SEMATECH and TRP. As projects move from underlying scientific knowledge closer to products and processes, the commercial benefits of that R&D are likely to be more apparent. Applied research projects could take numerous paths, and it is difficult to select a few projects from among several promising applications and then evaluate critically the role of federal support. Some analysts therefore contend that the private sector--with its vested interests in identifying commercial potential--is better suited to promote these types of R&D projects. Furthermore, if supported with federal funds, R&D programs can become entrenched politically and difficult to discontinue.

Supporters of these programs would argue that DoD should continue to fund SEMATECH and TRP because of their benefits to national security. Semiconductors are widely used in a variety of weapon systems, and SEMATECH could help keep the United States from becoming dependent on foreign suppliers for chips used in military equipment. Likewise, TRP may help maintain the base of U.S. companies that can produce defense equipment, help firms incorporate cheaper or more capable civilian components into weapon systems, or find new commercial applications for defense technology.

More generally, SEMATECH and TRP make up part of the Administration's technology policy, which is aimed at increasing and improving R&D. Advocates of technology policy see a role for the federal government in transforming scientific discoveries into commercial products by selectively promoting generic applied research--the development of technologies that are useful in more than one industry. In addition, SEMATECH has succeeded in some important respects, such as stimulating investment and encouraging clearer communication between producers and users of semiconductor manufacturing equipment. Because it encourages collaborative R&D, TRP may likewise improve communication among research teams, spread the risk inherent in large projects, or reduce duplication of research effort.

DEF-20 CUT FUNDING FOR MILITARY SPACE PROGRAMS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Savings from CBO Baseline						
Budget Authority	700	900	1,000	900	800	4,300
Outlays	260	560	760	860	860	3,300
Savings from CBO Estimate of Administration's Plan						
Budget Authority	0	0	0	0	0	0
Outlays	0	0	0	0	0	0

Military space programs, as defined by the Department of Defense, consist of launch vehicles, satellites, communications systems, navigation systems, and various space-related projects. The Congress has expressed concern about the affordability of these programs in light of DoD's plans to spend about $3.6 billion in 1995 on acquiring selected major space programs, excluding the Strategic Defense Initiative. In the 1993 defense authorization act, the Congress directed DoD to review space programs and policies and to develop alternative plans that could save up to 15 percent compared with the Bush Administration's January 1992 plan. The Clinton Administration subsequently initiated a comprehensive policy review that delayed DoD's alternative plans for reducing the space program.

The Administration's budget request achieves the Congress's goal of reducing spending for military space programs by 15 percent below the 1992 plan. By canceling the Follow-on Early Warning System, the Spacelifter, and the Landsat Remote Sensing Program, the Administration effectively reaches the goal set by the Congress in 1993. If the Congress approves the Administration's plan, savings would approach $700 million in 1995 and total $4.3 billion through 1999, compared with the CBO baseline. Should DoD or the Congress choose to restore any of these programs, the projected savings would not be achieved and the Congress's goal of 15 percent savings would not be reached.

Cutting military space programs is not without risk, however. These programs play a critical role in various national security functions including military operations, intelligence reporting, and support during a crisis. Operation Desert Storm used various space-based capabilities, such as the Defense Support Program and the Defense Satellite Communications System, that played vital roles in the coalition's success. Any reductions in spending for space programs should preserve the ability to perform these critical missions. In particular, imposing proportional reductions on all space programs could delay some that deserve high priority. Specific proposals for appropriate priorities within a declining budget should be identified in DoD's revised plans, which may also analyze the advantages and disadvantages of alternative programs, including their impact on the industrial base, their ability to meet requirements, and potential revisions to the military departments' roles and missions.

DEF-21 USE EARLY RETIREMENT TO REDUCE THE NUMBER OF MILITARY PERSONNEL

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Savings from CBO Baseline and CBO Estimate of Administration's Plan						
Budget Authority	640	1,520	1,250	960	660	5,030
Outlays	580	1,450	1,260	980	680	4,950

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The National Defense Authorization Act for Fiscal Year 1993 allows the service secretaries to permit military personnel to retire with as few as 15 years of active service. That provision differs from normal retirement at 20 or more years of service in two important respects: (1) the service secretaries may prescribe eligibility criteria involving factors such as grade, years of service, and skill; and (2) the member's annuity amount, although based on the same formula used for normal retirement, is reduced by 1 percent for each year short of 20 that the member retires. Authority for early retirement expires on October 1, 1999.

How the Department of Defense uses the authority could have important effects on both near-term defense costs and long-term federal costs for military retirement. The services could use early retirement to avoid the need to separate involuntarily senior members who are eligible for normal retirement, to reduce the need for involuntary separations of more junior personnel, as a substitute for other incentives designed to encourage the voluntary separation of career members, or to speed up personnel reductions. All of these policies would tend to reduce near-term defense costs, but only the last--speeding up the reductions--would definitely reduce federal outlays in both the near and the long terms.

This option would link the services' use of the early-retirement incentive in 1995 to reduced personnel levels, thus ensuring long-term savings in retirement costs. The Congress would direct DoD to grant early retirement to at least 73,000 personnel during 1994 and 1995. That number is the difference between the Administration's planned personnel levels at the end of 1995 and at the end of 1999. It is somewhat lower than the difference between the number of people now serving with 15 to 19 years of service and the number that would be serving in the long run in the smaller force planned for the future, which is one estimate of the number of excess personnel in that experience range.

Compared with either the CBO baseline or the Administration's plan, savings in federal budget authority under this option could total about $5 billion over the 1995-1999 period. These savings assume that personnel levels in 1995 would be reduced by 49,000, the number of additional early retirements beyond the Administration's plan. Personnel levels in later years would gradually return to the Administration's planned levels because the people who retired early in 1995 would otherwise have left the service. The savings are net of the retirement benefits paid to the early retirees, which would total $1.6 billion over the five years. Savings in the defense budget, shown in Appendix A, include reductions in the accrual charges for military retirement that DoD pays into a trust fund. These reductions in DoD outlays are offset in the total federal budget.

In addition to the near-term savings, long-term outlays for military retirement would decrease under this option. For each officer who retired at 15 years of service, total retirement payments would be reduced by at least $50,000 in present-value terms--$130,000 or more if the officer would have received another promotion had he or she not retired early.

Comparable reductions for an enlisted member retiring at 15 years of service would be $22,000 and $60,000 or more, respectively.

If personnel levels are not reduced, long-term retirement costs could increase substantially. The services might then use early retirements to lessen the need for the voluntary or involuntary separation of other career personnel who were not eligible for retirement. If allowed to stay, many of them would eventually qualify for retirement at 20 years of service, costing the government much more than it would save as a result of the early retirements.

Critics of using early retirement to reduce the size of the military might argue that the primary obstacle to faster personnel reductions is not the availability of tools for separating personnel but the inability of the personnel management system to replace departing personnel rapidly in the units that need them. Increasing the number of separations compounds the problem, even if the services do not need the additional personnel in the long run. Critics might also argue that the early-retirement program would not reduce the services' use of other separation programs; rather, early retirement would allow the services to raise the number of new recruits to levels consistent with their long-term needs. Finally, extensive use of early retirement, which this option would virtually guarantee, might create pressure to continue the program beyond its current expiration in 1999. Continuing the program could lead service members to view retirement after 15 years of service as the norm rather than as a temporary authority to meet extraordinary needs.

DEF-22 RESTRUCTURE OFFICER ACCESSION PROGRAMS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Savings from CBO Baseline						
Budget Authority	120	200	290	380	380	1,370
Outlays	110	190	280	380	390	1,350
Savings from CBO Estimate of Administration's Plan						
Budget Authority	130	210	300	390	390	1,420
Outlays	110	200	290	390	400	1,390

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The military services have drawn on several management tools to reduce the size of the officer corps. They have encouraged voluntary separations through specific actions such as tightening criteria for promotion and liberalizing early-out procedures. They have reduced the number of senior officers by selective early retirement, and they can make further cuts through reductions in force if necessary. Finally, the military services have reduced the number of new officers (accessions) who enter the force each year, consistent with the projected smaller force.

This option would restructure officer accession programs beyond the changes the Department of Defense has already made. Overall accession levels would not be cut below the level planned by the department, but more officers would be drawn from lower-cost commissioning programs--Reserve Officer Training Corps (ROTC) and Officers Candidate School/Officer Training School (OCS/OTS)--and fewer from the more costly service academies. In addition, a ceiling would be placed on the per capita amount that could be spent on each recipient of a ROTC scholarship. Further, the option would cut Junior ROTC programs and eliminate the preparatory schools operated by the service academies. Relative to either the Administration's plan or the CBO baseline, DoD would realize savings of about $130 million in 1995 and a total of $1.4 billion through 1999.

Of this total, $1 billion would come from cutting class size at the three service academies. At present, each academy graduates about 1,000 second lieutenants or ensigns a year. This option would reduce that number to 625 by cutting the size of the entering class for the three academies from a total of 3,000 to only 1,875. Estimated savings from this action reflect only those costs that would change in the near term, such as faculty and cadet pay and operating expenses. These savings would be offset by the additional costs needed to procure officers from OCS and ROTC to replace those from the academies, which would total about $55 million over the five years. In the longer term, savings also might accrue from changes in the academies' physical plant.

Additional savings under this option would stem from changes in the structure of ROTC programs. In 1994, DoD plans to spend $132 million for ROTC scholarships. (DoD covers other costs of education, but this option deals only with tuition.) About 30 percent of ROTC students now attend private institutions. The average cost per student in 1993 for tuition at four-year private institutions, based on data from the Department of Education, was $10,400 a year, more than four times the average cost of $2,400 at public universities. The option would cap ROTC scholarships at the $2,400 level consistent with average tuition at public insti-

tutions. Under a cap, DoD might choose to reduce the number of units at high-cost institutions, reallocating resources to lower-cost schools in order to maximize the number of officers trained. Alternatively, the department might elect to pay only a fraction of total tuition at high-cost institutions, requiring the student to make up the difference. Students currently enrolled would be allowed to complete their education without financial penalty.

Further, this option would cut Junior ROTC programs by about 25 percent. Junior ROTC provides introductory military training and uniforms to students in secondary school, at an overall cost in 1994 of $140 million. Recent Congressional action significantly expanded Junior ROTC in an effort to place more units in the inner cities. The reduction called for in this option would restrict this expansion by 50 percent. DoD could retain units in urban areas or elsewhere. Savings would be $40 million in 1995 and $200 million over five years.

Finally, the option would close the preparatory schools operated by each service academy. These schools accept students who cannot meet the stringent admission criteria of the academies and gives them a year of additional training and schooling so that they can gain entry to an academy. Savings in 1995 would be about $20 million and would total about $130 million through 1999.

Supporters of the military academies have contended that these programs are needed to produce future service leaders. This argument has not persuaded the Congress, but past attempts to mandate cuts at the academies have been only partly successful; class size has declined modestly, but academy graduates now account for a larger share of officer accessions than at any time since at least 1980. There is little evidence for the contention that the academies have already reduced their class size to the minimum efficient level, as supporters have claimed in arguing that further cuts would not produce savings.

Opponents of a dollar ceiling on ROTC scholarships might argue that the quality of a graduate from a private institution is higher than that of a graduate from a public institution. Setting a cap--and limiting the number of accessions from private institutions--thus might reduce the overall quality of the officer corps. However, the national security benefits of paying the higher tuition at private schools are unclear at best. Supporters of the public educational system might claim that the quality of education at public schools equals that provided at private ones.

Proponents of Junior ROTC include many Congressional supporters, who contend that it provides discipline and reinforces positive values for teenage youth, particularly in inner-city schools. Nonetheless, the program's contribution to national security is difficult to measure, and if its benefits lie in the behavioral changes it encourages, it arguably should be funded in competition with other social programs targeted toward such populations.

Similarly, supporters of the service academies' preparatory schools claim that those schools are needed to provide an opportunity for students from less fortunate circumstances to enter the military academies. These schools also provide an avenue for enlisted personnel to enter the academies. Opponents argue that the schools are used to enable the academies to recruit athletes and minorities who cannot otherwise qualify for admission, and that at an average total cost of about $40,000 per student they are more expensive than most other secondary education or than OCS/OTS programs, the primary avenue of commissioning for enlisted personnel.

DEF-23 REDUCE THE SIZE OF THE ARMY NATIONAL GUARD AND RESERVE

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	200	610	1,040	1,500	1,990	5,340
Outlays	190	590	1,030	1,490	1,970	5,270
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	50	160	350	610	900	2,070
Outlays	50	150	340	610	890	2,040

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

In the aftermath of the Cold War, military forces are undergoing a major downsizing as budgetary resources are reduced. As part of this effort, active Army forces will decline from a level of 780,815 in 1987 to about 495,000 in 1999--a 37 percent reduction. The drawdown of Army National Guard and Reserve strengths, however, is occurring at a much slower pace. Under the Administration's plan, the combined strengths of these two components will decline by only 25 percent between 1987 and 1999, to a level of 575,000.

This relative shift in favor of reserve forces may not be entirely the result of planning. In the past, when the Department of Defense has tried to reduce reserve forces more nearly in proportion to cuts in active forces, the Congress has consistently added strength back to reserve levels. For example, in the 1993 budget, the Administration requested an overall reduction of 108,000 reservists, but the Congress authorized a cut of only 35,000.

This option would reduce Army National Guard and Reserve strengths about 16 percent below levels projected through 1999, to mirror the 37 percent decline in active Army forces between 1987 and 1999. Compared with the Administration's plan, that translates into additional cuts of 9,000 Army reserve personnel in 1995 and more than 90,000 through 1999. Savings in the cost of personnel and day-to-day operations would equal $50 million in 1995 and $2.1 billion over five years as compared with the Administration's plan. Savings compared with the CBO baseline would be much larger--$200 million in 1995 and $5.3 billion through 1999--because the baseline projects a continuation of strengths at 1994 levels. Total savings could be even greater if the Congress reduced funds for purchasing reserve equipment in proportion to the cuts in reserve strength.

The National Guard and Reserve are an integral part of the total Army; they provide essential support and augmentation for active forces during both peacetime and wartime. Under current and planned alignments of reserve and active forces, the active forces could not perform many of their wartime missions without support from the reserves in areas such as medical resources, logistics, and transportation. Many reserve support units were deployed during Operation Desert Storm and by many accounts made important contributions. Some Members of Congress point to this experience in support of their view that the Department of Defense has placed too little value on the contribution of the reserves.

Supporters of the Army reserves also argue that maintaining large reserves (even at the cost of having smaller active forces) will save money without appreciably diminishing national security. The cost of manning and operating Army reserve units typi-

cally averages about 25 percent of that of similar active units. A major recent study by RAND, conducted for DoD at Congressional direction, found that these savings come at the price of lower readiness. Nonetheless, the longer mobilization times that the Army reserves require may not pose a problem in light of the reduced threat of a major European war in which large numbers of reserves would be needed.

Others might contend, however, that in an era of diminishing threats to U.S. security, the reserves should be reduced proportionately to the active forces. In this view, it makes little sense to retain all or most of the reserves when many of the active units that they support are being eliminated. Indeed, the opposite approach may be appropriate: as forces become smaller, a larger fraction may have to be on active duty so they can respond to crises on short notice.

Moreover, although the Guard and Reserve have performed well when called upon, reservists are part-time military members who train, on average, much less than active-duty personnel. Because of the differential in training time, the reserve units that perform best may be those that face narrower missions with simpler constituent tasks.

According to this argument, reserve ground combat units will always be less ready to perform because they are unable to train in some of the more complex tasks required on the modern battlefield. The recent RAND study of the mix of active and reserve forces concluded that early-deploying reserve ground combat units might take four months or more to reach the level of readiness of comparable active units. Advocates of larger cuts in Army reserve forces contend that this disparity makes it unwise to rely on the reserves to be able to meet the contingencies that the United States is likely to face in the post-Cold War world.

DEF-24 RESTRUCTURE RESERVE COMPENSATION

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
	Savings from CBO Baseline					
Budget Authority	410	420	440	450	470	2,190
Outlays	390	420	440	450	470	2,170
	Savings from CBO Estimate of Administration's Plan					
Budget Authority	390	380	370	370	370	1,880
Outlays	370	380	370	370	370	1,860

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

In 1994, nearly 1 million people will serve part time in the reserves, with personnel costs of roughly $5.8 billion. These personnel typically participate in 48 training drills per year, which usually involve one weekend of reserve duty each month, and also serve on active duty for two weeks each year. These reservists are compensated with pay and allowances for time spent training as well as with credit toward military retirement benefits.

This alternative would make three changes to the reserve compensation system that would save about $400 million in federal budget authority in 1995 and a total of about $2 billion through 1999 as compared with either the CBO baseline or the Administration's plan. Annual savings would continue to grow in the years beyond 1999. In addition to realizing savings, these alternatives would aim to simplify the reserve compensation system, treat different categories of reservists more equitably, and improve efficiency in personnel management.

Redefine and Reduce Drill Pay. During their two weeks of active training, reservists receive the same daily compensation as active-duty personnel, namely basic pay plus allowances for subsistence and housing. When reservists attend their weekend training, however, this parallel does not hold. In fact, reservists actually receive higher pay per day than their active-duty counterparts because reservists normally do their weekend training over 24 days but are credited with two drills per day for a total of 48. For each drill, a reservist receives "one day's" (that is, one-thirtieth of one month's) basic pay and credit toward retirement but no additional money for either subsistence or housing. Thus, the reservist receives two basic pays and double retirement credit for one day's work. That equates to being paid about 30 percent more per day than active-duty personnel.

This alternative would redefine drill pay so that two drills (one day's work) would be compensated with one day's total pay. Reservists would be treated on equal terms with active-duty personnel and would receive basic pay and cash allowances for subsistence and housing for each day of training, regardless of the type of training being performed. Savings in direct costs would average about $600 million in each of the next five years. In addition, the Department of Defense's required contribution toward reserve retirement would decline, but that would not affect total federal outlays over the next five years. Eventually, however, savings in retirement costs could substantially reduce federal costs.

Eliminate Dual Compensation for Reservists Employed by the Federal Government. More than 110,000 reservists are employed in civilian jobs in the federal government. These individuals benefit from the government's strong support of reserve training and may experience fewer conflicts with employers than do reservists who work in the

private sector. In addition, reservists employed by the government receive dual compensation--both their government and reserve pay--during their two weeks of annual training without having to use vacation time or annual leave. Although a few of the larger private-sector employers mirror this government pay practice, dual compensation is not the general rule for reservists who are employed outside the federal government.

This alternative would eliminate dual compensation for reservists who are given time off from their federal jobs to carry out their active-duty commitment. Instead, they would receive only the higher of the two payments during the service period. Savings would average just over $80 million in each of the five years. This particular proposal has been included in the National Performance Review initiatives and may be enacted next year.

Eliminate Reserve Retirement. The United States is the only country that offers retirement benefits to its part-time military personnel. These benefits parallel those provided for active-duty service and have remained largely unchanged since their enactment in 1948. Reservists are entitled to retired pay at age 60 after 20 years of active or reserve service, but at least the last eight years must have been spent in the reserves. The amount of retired pay is based on length of service and the average highest three years of pay. Payments to reserve retirees in 1993 totaled $1.9 billion. In 1995, DoD will set aside an amount equal to 10.5 percent of reservists' basic pay, or roughly $400 million, to pay for their future retirement benefits.

This option would terminate reserve retirement for those entering the reserve components after the end of fiscal year 1994. The federal government would not realize savings for many years because the actual payments would not occur until these new reservists reached age 60. Officers would be affected most because they receive about 80 percent of the total amount of retirement benefits paid to reservists, even though they constitute only 15 percent of reservists.

Although these three changes offer potential advantages, they could also raise problems. The changes would be imposed during a period of considerable turmoil caused by the reduction in the number of military personnel, including reserve personnel. Broad changes in the compensation system may be easier to effect once the drawdown is complete.

More importantly, these changes would result in lower paychecks for reservists and would eliminate their retirement benefits, which could lead to recruiting and retention problems. Retention is already lower among reservists who are at the early stages of their reserve careers than among their active-duty counterparts; additional losses among reservists could leave some reserve units without enough junior personnel to be fully effective in wartime. Problems of recruiting and retention may be at least partially offset as forces are reduced, because many former active-duty personnel are now seeking reserve positions. Once the active drawdown is complete, though, some of the savings from the other options--perhaps a substantial part--might have to be used to pay bonuses to offset any recruiting and retention problems.

The military could target bonuses toward those reserves most in demand, making payments at various points during reservists' careers to retain those with needed skills. Bonuses could also be used to recruit new reservists into areas that are difficult to fill. Added costs could average $230 million a year and are reflected in the savings noted above. The bonuses could be even higher if the Congress mandates an increased emphasis on reserve forces, which may mean relatively small reductions in reserves compared with those in the active forces.

The military could also use these bonuses to phase in the retirement changes more quickly, by offering reservists a choice between continuing under reserve retirement or potentially receiving bonus payments. Reservists choosing bonus payments would then forgo future retirement benefits.

DEF-25 DENY UNEMPLOYMENT COMPENSATION TO SERVICE MEMBERS WHO VOLUNTARILY LEAVE MILITARY SERVICE

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
	Savings from CBO Baseline and CBO Estimate of Administration's Plan					
Budget Authority	280	230	230	230	230	1,200
Outlays	280	230	230	230	230	1,200

Many military personnel who leave active-duty service are eligible for unemployment benefits. Their payment amounts are calculated in the same way as those of civilian personnel who qualify for unemployment benefits. However, eligibility of former military personnel differs from that of recipients in the civilian labor force in one important respect. Former military personnel can apply for and receive unemployment benefits even if they voluntarily leave military service, but civilian recipients must have lost their jobs involuntarily.

The majority of personnel who leave military service do so voluntarily. For example, many choose not to reenlist following completion of their term of service; others, who have completed a minimum of 20 years of service, opt for voluntary retirement. Still others may choose to leave military service in return for cash payments under the voluntary separation incentive and special separation benefits programs enacted in 1991. A much smaller group is separated involuntarily for reasons related to job or promotion performance or, in recent years, because of the drawdown of military forces.

This option would apply the same rules to former military personnel that other members of the civilian work force must follow by stipulating that only personnel who left service involuntarily because of force reductions would be eligible to receive payments. Eliminating payments to individuals who leave service voluntarily would reduce the number of recipients by at least 50 percent, resulting in savings of about $230 million annually. Because the Department of Defense ultimately reimburses the Department of Labor for the cost of unemployment payments to former service members, these savings would occur in the defense budget. Savings under this option are relative to both the CBO baseline and the Administration's plan.

The unemployment insurance program was established with the intent of aiding those who lose their jobs involuntarily. Subjecting military personnel to the same rules as the rest of the work force regarding unemployment compensation thus could be seen as a more equitable use of an existing entitlement program. But if military service is considered to be fundamentally different from other types of employment, one could argue that voluntary separation from service is not comparable with voluntary termination of civilian employment and therefore should not be subject to the same restrictions on eligibility for unemployment compensation.

DEF-26 REDUCE DRILLS FOR NONCOMBAT RESERVE UNITS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	130	140	140	140	150	700
Outlays	130	130	140	140	150	690
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	130	120	120	130	130	630
Outlays	120	120	120	130	130	620

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The National Guard and Reserve play an important role in U.S. defense policy by providing a trained, combat-capable force that can be mobilized in time of war. Some of these reserve units are included in the forces that deploy overseas early in a major conflict. Others would supplement existing active units and would provide much of the combat support needed to fight a war.

Some reserve units, however, have noncombat-related missions that may not be needed immediately or that may be met by the civilian sector. Included in this category are units such as bands and those that provide administration, food services, registration of combat casualties, and laundry services. Like units directly involved in combat, reservists in these noncombat units are paid to train full time for two weeks each year and to drill for one weekend each month (drills total 48 because there are four per weekend).

This alternative would reduce the number of weekend drills for the roughly 90,000 reservists in these noncombat units from 48 to 24. Members would still be paid to train full time for two weeks each year, but on average they would train for one weekend every other month instead of each month.

Compared with the CBO baseline, savings in the first year would be $130 million, with cumulative five-year savings totaling $700 million. Savings would be smaller relative to the Administration's 1995 plan, which assumes a smaller number of reservists.

Reducing drills for these noncombat units may not harm readiness and warfighting capabilities. In many cases, required skills could probably be maintained even with the reduced amount of weekend training. Because total pay would be reduced, fewer reservists might be willing to serve in these units, and shortages could occur. But most of the general skills required are readily available in the civilian sector, so qualified personnel could presumably be recruited in the event of a war. Also, as levels of active-duty personnel are reduced during the next few years, a larger pool of manpower will be available from which to meet requirements for the reserves.

A decline in the number of personnel willing to serve in these units, however, could create some problems in peacetime. Increased recruiting efforts may be needed to maintain the size of the noncombat units. Costs for this extra effort are not reflected in the savings shown above. If the size of these noncombat units declines, some of their peacetime functions--particularly administration and finance--might need to be transferred, resulting in increased work loads for other units or individuals.

DEF-27 REDUCE GOVERNMENT SPENDING FOR MILITARY HEALTH CARE TO ACCOMPANY CAPITATION

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	170	360	560	790	1,040	2,920
Outlays	120	300	490	710	950	2,570
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	160	340	530	740	980	2,750
Outlays	120	280	460	670	890	2,420

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The Department of Defense has determined its budgets for health care programs on the basis of historical patterns of provision of care and use of resources by military treatment facilities. This budgetary process rewarded hospital commanders with larger budgets if they provided more health care and thus offered few incentives to curb the delivery of unnecessary and inappropriate health care. Considering that DoD plans to spend almost $16 billion to support the military health care system in fiscal year 1994, the consequences of inefficient use of resources are serious.

To give hospital commanders a fiscal incentive to control costs, DoD introduced a system of capitated budgeting in 1994. Under capitated budgeting, each commander receives a fixed amount per beneficiary for providing all health care to the population within the hospital's defined service area. By limiting future budgets according to a fixed amount per person, capitation radically alters the incentives inherent in the previous system of budgeting, encouraging the commander to deliver only care that is both necessary and appropriate. DoD's systemwide approach to capitation, however, projects resource requirements on the basis of historical spending patterns. To the extent that inefficiencies are part of the current medical care system, capitation thus may tend to perpetuate them.

This option focuses on the delivery of health care to military dependents and retirees, who receive much of their care in military medical facilities. To reinforce the incentives under capitation for hospital commanders to use resources more efficiently, this option would adjust capitation rates to require DoD to bring the use of health care more closely in line with civilian rates for military beneficiaries under the age of 65 (with the exception of active-duty personnel). Because hospital commanders may find it difficult to control the use of health care that beneficiaries receive from civilian health care providers (reimbursed under the Civilian Health and Medical Program of the Uniformed Services), this option adjusts capitation rates to reflect reductions in health care use only at the military facilities. Based on the higher patterns of rates of use in the military compared with those in the civilian sector, DoD could lower health care costs by about $160 million to $170 million in 1995 and $2.8 billion to $2.9 billion over the next five years, in comparison with both the CBO baseline and the Administration's plan. Under this option, DoD is assumed to set aside 10 percent of total savings, which hospital commanders would be allowed to retain to enhance the delivery of services at military medical facilities.

Compared with the U.S. population at large, military beneficiaries under age 65 (excluding ac-

tive-duty personnel) make heavy use of both inpatient and outpatient services. In 1992, civilians in the United States under the age of 65 used about 530 days of hospital care per 1,000 people and made 4.5 outpatient visits per person. When adjusted for the distribution of that civilian population by age and sex, as well as insurance coverage, military beneficiaries under the age of 65 living in the United States used about 615 days of hospital care per 1,000 people and made 6.7 outpatient visits per person.

Improvements in efficiency are both necessary and possible under DoD's plans to integrate the military into national health care reform by establishing regional military health care plans that are competitive with civilian networks. Several of the managed care strategies that are now a part of many civilian plans could be employed to reduce the use of health care by military beneficiaries: for example, extending current guidelines on the appropriateness of inpatient care to the military treatment facilities, and establishing "gatekeepers" to control the use of outpatient care. In addition, the military may also need to consider strategies for controlling costs such as increased cost sharing by beneficiaries (see DEF-28).

Opponents of this option might argue that high rates of hospital use do not necessarily imply abuse of the military medical system. For example, because some civilians lack insurance coverage, nationwide rates of hospital use by civilians may actually be lower than medical considerations warrant. Military beneficiaries may actually be healthier than civilians because of their unimpeded access to care. That said, however, civilian health maintenance organizations have shown that high-quality care is achievable with rates of hospital use well below 400 days per 1,000 enrollees.

Opponents might also claim that basing funding on capitation risks giving hospital commanders insufficient funds to offer beneficiaries a military benefit plan consistent with the provisions of national health care reform. At present, military beneficiaries are not generally required to enroll in any plan as a precondition for using the military health care system. Capitation formulas, therefore, could be based only on DoD's estimate of the number of beneficiaries, and in practice more beneficiaries might elect to enroll than particular hospitals could accommodate. A capitation formula based on a system of enrollment in a military health care plan, as proposed under national health care reform, would provide a more accurate basis for making spending reductions and encouraging efficiency, but such a formula cannot be implemented before the national system is enacted. Waiting until then, however, would forgo the opportunity to squeeze any present inefficiencies from the military health care system.

DEF-28 REVISE COST SHARING FOR MILITARY HEALTH CARE BENEFITS

	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
	Savings from CBO Baseline					
Budget Authority	350	350	350	360	360	1,770
Outlays	270	330	350	350	360	1,660
	Savings from CBO Estimate of Administration's Plan					
Budget Authority	340	340	340	340	350	1,710
Outlays	260	320	330	340	340	1,590

About 8.5 million people are eligible to use the military health care system. That total includes all men and women on active duty, their spouses and children, and retired military personnel and their dependents and survivors. Those who choose to use this health care system receive most of their care in the military's hospitals and clinics (referred to as the direct care system). When beneficiaries receive care in military facilities, they pay very little. Hospital care costs between $4.75 and $9.30 per day for most beneficiaries; retired enlisted personnel pay nothing. Outpatient visits and prescriptions are free of charge for all beneficiaries.

When direct military care is unavailable or inaccessible for dependents and retirees under the age of 65, the Department of Defense reimburses civilian providers through a traditional fee-for-service insurance program known as the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS). Compared with cost-sharing requirements in military facilities, beneficiaries using CHAMPUS generally pay more. For inpatient care, for example, retirees must pay the lesser of $265 per day for inpatient care or 25 percent of hospital charges. For outpatient care, all users face both a deductible and copayments. Such low charges for military facilities lead to inefficiently high use of health care there and are inequitable to beneficiaries who must rely on civilian providers.

This option would equalize the cost-sharing requirements for outpatient care for all beneficiaries regardless of whether that care is received in a military or civilian setting. As a consequence, this option would address the twin problems of efficiency and equity. New cost-sharing requirements for direct military health care would be modeled after the civilian cost-sharing requirements proposed under Tricare, the health care plan that DoD plans to offer as its contribution to national health care reform. Savings could amount to about $350 million in 1995 and $1.7 billion through 1999 compared with either the CBO baseline or the Administration's plan. These savings stem from both the revenue generated from increased charges and the reductions in patterns of use by beneficiaries in response to higher cost sharing. Some of these savings, however, would be offset by the cost of modifying existing automated information systems to collect the higher fees.

The principal reason to revise the cost-sharing requirements for the military health care system is to slow the rising costs of providing military health care. Controlling these costs will be possible only if beneficiaries and providers alike face improved incentives of the kind incorporated in DoD's Tricare plan for care received in the civilian sector. Implementing this plan for military beneficiaries, however, need not impose onerous requirements on them because it should improve their access to less expensive care at military medical facilities.

Aside from raising revenue, this option would yield many other benefits. Higher charges for mili-

tary care would help curb excessive use in military facilities by creating the same incentives for beneficiaries who use the military treatment facilities as for those who use civilian providers. At the same time, charges for using direct military health care would also assist commanders in holding down costs through capitated budgeting. Under capitated budgeting, commanders of military treatment facilities receive a fixed amount based on the projected beneficiary population to be served (see DEF-27). This option would make cost-sharing requirements for military care similar to the low end of cost-sharing requirements proposed under national health care reform for the civilian sector. And it would eliminate the inherent inequity of providing more generous health care benefits to those who live near a military hospital or clinic.

There are disadvantages to this option. Because medical care is a key part of military compensation, military families might view increased charges as an erosion of benefits. That may be of particular concern during a major drawdown of forces, which has already created considerable uncertainty among military families. Recruitment and especially retention could suffer, although Tricare would continue to be significantly less expensive to join than other medical plans offered to civilian employees in either the federal government or the private sector. Nor should rising charges necessarily harm health, because evidence shows that people at ages and income typical of military beneficiaries seek needed care even when they share costs.

DEF-29 CLOSE THE UNIFORMED SERVICES UNIVERSITY OF THE HEALTH SCIENCES

	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Savings from CBO Baseline			
Budget Authority	20	30	40	70	70	230
Outlays	20	20	30	60	60	190
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	0	0	0	0	0	0
Outlays	0	0	0	0	0	0

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

Historically, the Department of Defense has faced shortages in medical personnel, particularly physicians. To alleviate this situation, DoD has developed various programs to provide a supply of these personnel. One such program is the Health Professionals Scholarship Program (HPSP), which pays tuition and a stipend to medical students and those in other health-related programs in return for a military service obligation. Another example is the Uniformed Services University of the Health Sciences (USUHS), a medical school operated by DoD.

The Congress created the university in 1972 to train physicians committed to long-term military careers. At a total cost of about $90 million in 1994, the school provides a full education for its participants, including a stipend to cover room, board, and books. Based on figures from 1991, USUHS is the most expensive source of military physicians at $562,000 per person. By comparison, scholarships cost $111,000, and other sources, such as the Financial Assistance Program and the Volunteers Program, range in cost from $55,000 to $13,500. Even after adjusting for the lengthier service commitment required of physicians trained at USUHS, their training cost is still higher than for physicians from other sources.

USUHS has met only a small fraction of DoD's need for new physicians--less than 12 percent in 1992, for example. Scholarships provided about 73 percent, and the remaining 15 percent came from other sources, including volunteers.

This option assumes that the class of students admitted in August 1993 would be USUHS's last; the institution would close at the end of fiscal year 1997 after those students have graduated. Other programs for obtaining physicians would be expanded to offset some of the loss of physicians. Compared with the CBO baseline, which assumes continuation of the USUHS program at current levels, net federal savings would be about $20 million in 1995 and $230 million over five years. These savings include reductions in military and civilian personnel assigned to the university and would be in addition to planned drawdowns. They also reflect the added cost of obtaining physicians from other sources, such as the HPSP.

The Administration supports this option. On the basis of findings by Vice President Gore's National Performance Review, the Administration's budget for fiscal year 1995 also proposes to close USUHS at the end of fiscal year 1997 on the grounds that DoD can obtain medical personnel less expensively from other sources.

This proposal has some drawbacks. Supporters of USUHS claim that its physicians are better trained for the special needs of the services because of the university's focus on the study of military

medicine and preparation of military medical officers. In addition, some of the higher costs of USUHS are repaid, in effect, because USUHS-trained physicians have a longer service commitment than physicians from other sources. For example, graduates of USUHS must pay back seven years of active duty, whereas scholarship recipients must pay back only about one year of active duty for each year of health professional training. The longer tenure of USUHS graduates may enhance stability in the medical corps and reduce demands on the other sources of physicians. Perhaps because of these considerations, the Congress strongly backed the creation of USUHS and has consistently given the institution full financial support.

Reflecting its concern about the general state of military medical care, the Congress in recent years has limited the authority of the military departments to reduce the number of health care personnel. Some Members of Congress might oppose closing USUHS because that could contribute to a shortage of military doctors. Other programs to improve military medical care, such as allowing military medical commanders to hire civilian medical personnel, might allay Congressional concerns on this score. For example, the Military-Civilian Health Service Partnership Program allows commanders of military treatment facilities to enter into agreements with civilian providers to compensate for staff shortages, thus improving access to services for beneficiaries. Alternatively, if the Congress allows the military departments to reduce the number of physicians below current targets, then the loss of USUHS physicians could be partially offset by the smaller number of physicians required. Expansion of existing programs could make up the rest of the loss.

Direct cost comparisons between USUHS and other sources of physicians may be unfair to USUHS because of indirect subsidies that the federal government provides to medical schools, which in effect raise the true governmental cost of physicians from sources other than USUHS. Nonetheless, even taking these subsidies into account probably would not affect the conclusion that USUHS remains a relatively expensive source of military physicians.

DEF-30 REDUCE FUNDING FOR DEFENSE ENVIRONMENTAL PROGRAMS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
	Savings from CBO Baseline and CBO Estimate of Administration's Plan					
Budget Authority	300	310	320	340	350	1,620
Outlays	210	270	300	320	330	1,430

Although defense spending has declined by about 15 percent since 1990, funding for environmental security programs has increased by about 290 percent. In 1990, the Department of Defense spent $1.4 billion on environmental programs for cleaning up operational bases and closing military installations, complying with federal and state standards in handling hazardous waste materials, and conducting research and development of environmental remediation technologies. In 1994, the Congress authorized $5.4 billion for these activities, an increase of $200 million over the Administration's request. The Administration's plan includes $5.7 billion for environmental programs in 1995 and $26.2 billion over the 1995-1999 period.

Compared with the Administration's plan and the CBO baseline, this option identifies potential savings of $300 million in 1995 and $1.6 billion over the five-year period through 1999. These savings would result from adopting less stringent cleanup standards, reducing management costs, and using new remediation technologies. Such changes in DoD's environmental programs would be consistent with concerns expressed by oversight committees in the Congress.

Despite the recent dramatic increase in funding for environmental programs, DoD has achieved only limited progress in cleaning up the 18,795 contaminated sites on its 1,800 installations. Most of the work to date has involved identifying and characterizing contamination, and little actual cleanup has been accomplished. As of April 1993, the department reported that cleanup activities were complete or under way at fewer than 4 percent of the total number of contaminated sites.

The Congress has expressed concern about the lack of progress being made in the cleanup program and--despite the overall growth of funding for cleanup in recent years--has indicated that, in some instances, reductions in funding may be warranted. For example, the House Committee on Appropriations recommended a $600 million reduction in spending in 1994, concluding that less stringent cleanup standards for military bases being closed could provide significant savings. CBO does not have data to support the details of that estimate, but recent experience at Mather Air Force Base in California illustrates the potential for savings from less stringent cleanup standards. DoD has estimated that the cost of cleaning up Mather Air Force Base could be reduced by 25 percent or more with such standards.

It is difficult to estimate the total savings that might stem from less stringent standards, reduced management costs, and more efficient remediation technologies. The projections in this option were chosen to lie between the reductions imposed last year by two Congressional committees.

Recent advances in remediation technologies could yield significant savings. The department might achieve near-term savings by revising sampling and analysis practices during the early phases of the cleanup process. For example, a recent DoD study of five contaminated sites found that the application of statistical design techniques in sampling to characterize and monitor contamination could save as much as 30 percent compared with the cost of current approaches. In addition, new technologies, such as the Site Characterization and Analysis Penetration System, a type of ground radar, ac-

Penetration System, a type of ground radar, accounted for savings of an additional 7 percent compared with past practices. DoD estimates that the application of these new techniques could save between $56 million and $246 million for some 900 sites requiring characterization work. The study also concludes that more effective characterization could save significant costs, perhaps billions of dollars, during the remediation phase.

Savings might also be achieved during the next several years by applying certain new technologies during the remediation phase. For example, the current cost of cleaning contaminated soil by incineration varies from $350 to $1,500 per ton. Bioremediation techniques, such as composting, can achieve the same standards at a considerably lower price--between $100 and $400 per ton. Recent cleanup work under way at Umatilla Army Depot in Oregon confirms that composting is an effective alternative to incineration.

Application of new technologies for treatment of fuels and solvents in groundwater also has the potential for considerable savings during the next few years. Current technologies such as air stripping and activated carbon adsorption cost between $5.00 and $7.50 per 1,000 gallons of contaminated groundwater. The department estimates that by 1996, crossflow air stripping with catalytic oxidation could reduce costs to as little as $1.50 per 1,000 gallons.

But the policy changes underlying the estimated savings are not without risk. The savings estimates for site characterization are based on a limited number of samples and may not be achievable for all contaminated sites. Similarly, DoD's estimated savings for applying new technologies during the remediation phase are based on laboratory results and reflect only limited experience in the field.

Also, the potential savings from the application of new technologies during the characterization and remediation phases of cleanup may not be realized as quickly as DoD has estimated. Few of the new remediation technologies are mature enough to be used on a wide scale during the next year or so. Thus, a disproportionate share of the near-term savings assumed in this option may have to be achieved through management changes.

Finally, the possibility of realizing savings through adopting less stringent cleanup standards is subject to the vicissitudes of negotiation among the Department of Defense, the Environmental Protection Agency, and the states. In some cases, such as George and Mather Air Force bases and the Rocky Mountain Arsenal, disagreements among DoD, EPA, and the states have occurred and more stringent cleanup standards were eventually adopted. Less stringent standards could be agreed upon in other cases, but in any event, the resulting standards are a matter for negotiation.

DEF-31 REDUCE FUNDING FOR DOE'S CLEANUP PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Savings from CBO Baseline						
Budget Authority	630	650	670	690	710	3,350
Outlays	310	550	650	670	690	2,870
Savings from CBO Estimate of Administration's Plan						
Budget Authority	630	660	670	690	700	3,350
Outlays	310	550	660	680	690	2,890

The Department of Energy (DOE) is responsible for operating, maintaining, and cleaning up the large complex that develops and produces nuclear weapons. In 1989, the Environmental Restoration and Waste Management (EM) program was created within DOE to oversee and direct all aspects of that cleanup. Since that time, the program's annual budget has more than tripled, from slightly under $2 billion in 1989 to over $6 billion in 1994. The Administration has requested more than $6 billion in budget authority for 1995 and plans to budget a total of almost $34 billion in the next five years.

As budget levels for the program continue to rise, so do concerns regarding the efficiency and feasibility of the program as it is currently structured. This option would reduce spending in this program by 10 percent below the Administration's plan in each year from 1995 through 1999. Savings would be realized by reducing spending for administrative and support functions and by delaying some projects in the environmental restoration program. Relative to the Administration's plan, savings would be $630 million in 1995 and a total of $3.4 billion through 1999. Savings would be similar relative to the CBO baseline.

One concern voiced both by critics outside DOE and by high-level managers within the department is that the EM program is not being managed efficiently. Several factors contribute to the perception that significant portions of EM funds are being wasted on unnecessary administrative and support activities. At each of DOE's 15 major sites, a single management and operations (M&O) contractor is responsible for all phases of on-site operations. In some cases, the same contractor is responsible both for production and for cleanup of any wastes resulting from that production. DOE also contracts with an additional firm at many sites for architectural and engineering (A&E) work. Some critics of DOE have argued that this arrangement has led to duplicate layers of bureaucracy and administration as both the M&O and A&E contractors subcontract for the performance of specific tasks. In addition, until recently, contracts between DOE and M&O contractors were subject to less scrutiny than other government contracts, and many contained clauses that were unusually favorable to the contractors. DOE and its predecessors justified these unusual contracting practices based on the unique and secret work performed at the nuclear weapons complex.

Several reviews of the budget for the EM program conducted by both internal and external review teams have found excessive levels of funds devoted to management functions. In the past, the Congress has directed DOE to reduce these costs, and the Assistant Secretary of Energy for EM has acknowledged the potential for savings in this area. Means suggested for achieving such savings include reforming the contracting process, eliminating unnecessary programs or those duplicated elsewhere in the federal government, and tightening oversight of contractors' performance.

Another concern often expressed about DOE's cleanup effort is that in many cases DOE does not have any techniques for effectively cleaning up its contaminated groundwater and soil. A large portion of DOE's funds allotted to remediation are devoted to cleaning up contaminated groundwater, soil, or buildings--tasks that are difficult and expensive to accomplish with today's techniques. At the same time, DOE is investing its own money to develop new techniques to perform these tasks more quickly and cheaply. By delaying remedial actions that are difficult to accomplish with today's techniques until more efficient methods are available, DOE could not only save money and time in the long run but also realize budgetary savings in the near term.

By reducing funds dedicated to administrative and support functions and delaying some remediation projects, DOE could achieve significant savings--perhaps on the order of 10 percent--over the next five years. Savings of this magnitude in annual budgets have been discussed by previous reviewers of the EM budget. Moreover, changes sufficient to generate these savings might be acceptable to the many parties involved in cleanup efforts. For example, a recent agreement between DOE, the federal Environmental Protection Agency (EPA), and state regulators stipulated that savings of more than 10 percent would be achieved at the Hanford site.

Reducing total EM funding by 10 percent, however, could cause problems for DOE. Reducing funding for administration and support without specific proposals for realizing savings could hamper execution of the program rather than make it more efficient. Although the Congress does not have direct oversight of administrative costs and so cannot eliminate or reduce them directly, it could mandate savings and instruct DOE to realize them through better management. Alternatively, it could require DOE to provide the Congress with more information, thus enabling better Congressional oversight.

Reducing funding for remediation programs could also have drawbacks. DOE feels it must proceed with many difficult and expensive remediation projects because it is required to do so by the agreements it has signed with various states and EPA. Those agreements stipulate when DOE must start and finish many cleanup tasks. Delaying projects would require renegotiating at least some of those agreements. Furthermore, some remedial action may be required immediately in order to protect the environment or public health. Finally, if long-term benefits are to result from delaying technically difficult projects, DOE might have to invest additional money in the meantime to develop better technologies to execute the projects more efficiently. Those investments might reduce the savings available under this option unless they can be accompanied by larger cuts in support or other activities.

DEF-32 REVAMP MILITARY FAMILY HOUSING

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Savings from CBO Baseline and CBO Estimate of Administration's Plan						
Budget Authority	690	720	730	680	560	3,380
Outlays	50	320	530	710	490	2,100

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

More than two-thirds of the military families in the United States receive cash housing allowances and either rent or purchase housing in the private sector. The rest (approximately 30 percent) forfeit their cash housing allowances and live in housing units provided by the Department of Defense. DoD's policy is to rely on cash allowances wherever the private sector is able to provide adequate, affordable housing. Nonetheless, CBO projects that the percentage of military families in the United States living in DoD housing will increase from 30 percent to 38 percent between 1990 and 1999. In the long run, that increase means higher costs for DoD because the average annual cost of providing DoD housing (including the amortized cost of construction) is approximately $11,000 per unit, compared with approximately $7,000 for housing allowances.

Increased use of DoD housing could also push up costs over the next several years. Most of DoD's U.S. inventory of family housing was built early in the Cold War, when domestic housing was in short supply and when DoD first faced the task of rotating a large standing army between assignments in the United States and overseas. These housing units are near the end of their service lives. Significant budgetary savings are possible in the near term if, rather than replacing or revitalizing its existing stock, DoD were to retire these aging units and rely more on private-sector housing. In recognition of this, the conference committee's report on the 1994 appropriation bill for DoD family housing asked the services to consider closing units that have deteriorated, especially those in localities that have adequate and affordable housing in the private sector.

The current system of housing allowances, however, discourages reliance on the private sector. Families have a strong financial incentive to live in on-base housing because the allowances do not fully cover the cost of obtaining private-sector housing. Despite DoD's stated policies regarding reliance on the private sector, it will be difficult for the department to reduce its role as a direct provider of housing when there are long waiting lines for existing on-base units.

This option would change the incentives that military families and DoD housing managers face. Under this option, all military personnel eligible for family housing would receive cash housing allowances regardless of whether they lived in DoD or private-sector units. Families choosing to live on-base would be charged rent. Rents for each type of housing unit at each installation would be adjusted based on the actual demand for those units; rents would fall when there were vacancies and rise when there were waiting lists. DoD would continue to operate existing units as long as the rent--the value of the unit to military families--covered DoD's operating costs. It would authorize revitalization or replacement, however, only in locations where the value of the unit to service members (the rent level) was at least as great as the cost of operations plus amortized construction costs.

Savings compared with both the CBO baseline and CBO's estimate of the Administration's plan could amount to $690 million in 1995 and $3.4 billion through 1999. Over the very long run, estimated annual savings in the steady state could be $500 million.

Some of the savings under this option would derive from more efficient management of existing units: for example, the metering of utilities lowers energy costs (metering becomes equitable under a rental system since units with low energy efficiency would rent for less than other units), and eliminating the waiting lists yields savings in turnover of units and moving costs. Other savings would derive from lower revitalization and replacement costs, since existing DoD units would be revitalized or replaced only in locations where the rent that service members were willing to pay covered the full cost to DoD of providing the units. Still other federal savings would come from reduced school Impact Aid; since on-base housing is not subject to local property taxes, the Department of Education pays federal Impact Aid for schools to local governments to offset the cost of educating the children who live on-base.

These savings assume that rents for only 25 percent of existing DoD units would meet the criteria for revitalization or replacement. The estimates reflect the cost of raising the housing allowances to hold constant the total out-of-pocket cost incurred by service members (the difference between their total expenditures on housing and the total amount of allowances provided). Holding those costs constant ensures that the savings shown above reflect real savings in resources, not just a transfer of dollars from the pockets of service members to DoD.

In the long run, a rental system for DoD housing would allow DoD to provide service members with the same quality of life at lower cost. It would provide better signals about the value of DoD housing to service members and would encourage them to take into account the full costs of their choice when considering whether to live in on- or off-base housing. A rental system also would eliminate the costs and frustrations associated with the current system of rationing through waiting lists. The quantity and location of DoD housing units would be determined based on the preferences of military personnel. For example, rent levels for DoD units could signal the value of additional DoD units in areas where service members prefer to live on-base because the crime rate is high in the surrounding civilian community.

Disadvantages to this option include the costs of determining initial rental rates, setting up utility metering, and collecting rents. Special arrangements would have to be made for historic units (units that DoD must maintain even if rents do not cover operating costs) and for personnel who are required to live on-base to be available in the event that military needs arise (approximately 3 percent of all personnel). Since a rental system might have to be phased in as individuals started new tours, inequities might exist initially between individuals under the old system and those under the new. The option would also redistribute benefits: families who prefer to live in the private sector would be better off because of the higher allowances; families who prefer the on-base lifestyle would for the first time face the full cost of their choice.

Questions arise, however, about whether this is an appropriate time to consider such a change. On the one hand, decisions about revitalizing and replacing the 40-year-old housing stock must be made soon, which suggests that the market signals a rental system could provide would be particularly helpful right now. On the other hand, a major change in housing policies may be inappropriate at a time when the services are conducting a large drawdown and many military personnel are anxious or uncertain about their careers. That may be one reason that DoD is not currently considering a change of the sort envisioned in this option, although it has done so in the past.

DEF-33 ELIMINATE FEDERAL SUPPORT OF COMMISSARIES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	300	620	970	1,330	1,380	4,600
Outlays	230	530	860	1,220	1,330	4,170
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	280	550	810	1,060	1,040	3,740
Outlays	210	470	720	970	1,010	3,380

The Department of Defense currently operates about 360 military commissaries in the United States and overseas. These commissaries are like grocery stores, selling food and other products to military members, retirees, and their dependents. Commissary shoppers save an average of just under 25 percent compared with shoppers in civilian grocery stores. Established in 1866 to provide food and other items to military personnel assigned to remote posts, commissaries now are viewed as a benefit of membership and are entrenched as part of military life.

The commissary system will cost the federal government about $1 billion in appropriated funds in 1995. These funds pay for military and civilian salaries for commissary employees, transportation of goods to overseas stores, contractors, and other operating costs. This option would eliminate the $1 billion in appropriated funds, forcing the commissaries to become self-sustaining. Based on projected sales of $5.8 billion in 1994, the commissaries could do that by raising current prices by 20 percent, thus generating the needed additional revenues. Commissary goods would still cost about 5 percent less than those in civilian stores, on average. DoD would retain some flexibility for raising or lowering prices in remote areas where military members have few alternatives for shopping.

Because 20 percent is a large price increase, this option would phase out the subsidy gradually over four years. Over the next five years, total savings associated with eliminating the subsidy would be $3.7 billion compared with the Administration's plan. Savings would be somewhat larger relative to the CBO baseline.

Commissaries have far exceeded their original purpose of providing food items to active-duty military personnel in remote locations. They are open to many types of people, including retired personnel and their surviving spouses, certain personnel involuntarily discharged from service, disabled veterans and their surviving spouses, reservists, and officers of the Public Health Service, among others. Moreover, although commissaries were established in remote locations, there are now seven stores in the Washington, D.C., area alone. Ending federal support for the commissaries might force the system back toward its original purpose. To keep prices down, the commissaries might improve efficiency by cutting costs and then pass their savings on to commissary users. In fact, the Administration is reviewing several proposals to reduce the subsidy, though it is unclear whether a decrease will actually be recommended.

This option has important drawbacks. Commanders might argue that subsidized commissaries, along with other benefits unique to the military, foster a sense of esprit de corps that is important for retaining the cohesion necessary for combat. Eliminating this subsidy could be viewed as harmful to the quality of military life. The increase in commissary prices could lead to a significant reduction in sales and ultimately force the closing of some stores. The 1994 DoD authorization bill, however, expanded the commissary customer base, which should enhance the viability of commissaries even if their prices increase.

In addition, the higher prices that service members would have to pay would amount to a reduction in the net value of military compensation. DoD would probably argue for a comparable increase in pay to offset the resulting negative effects on recruiting and retention. If pay was not raised, military personnel might view their higher cost of living as an unfair erosion of their benefits, which could harm morale. Finally, subsidized commissaries are popular with military personnel. Terminating such a popular benefit in the midst of the turmoil associated with a major reduction in the number of military personnel may not be appropriate.

DEF-34 REDUCE SUBSIDIES FOR MORALE, WELFARE, AND RECREATION PROGRAMS

	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
	Savings from CBO Baseline and CBO Estimate of Administration's Plan					
Budget Authority	100	210	320	450	580	1,660
Outlays	70	170	270	390	510	1,410

The Department of Defense spends about $1 billion a year to maintain an extensive system of programs designed to enhance the quality of life of its military members. These programs, which are referred to as morale, welfare, and recreation (MWR) activities, are divided into three categories that reflect differences in the proportion of costs paid by users through fees and by the government through appropriated funds.

Category A includes mission-related activities such as fitness centers, libraries, and recreation centers. Just over half of the funding for these activities comes from appropriations (almost $500 million in 1992), with the rest paid from user fees. Category B activities include child care, community programs, and individual recreation such as arts and crafts. In 1992, DoD's appropriations provided just under $400 million, or 40 percent, of the costs of these activities. (Of this total, $180 million was for child care.) Category C activities cover post exchanges, cafeterias, bowling alleys, and similar facilities. Over $250 million of appropriated funds was spent for Category C, about 10 percent of the cost of these activities.

This option would gradually reduce the level of appropriated funding for MWR activities, cutting it by an additional 10 percent each year from 1995 through 1999. By 1999, appropriated support would be reduced by 50 percent. Compared with the Administration's plan and the CBO baseline, net savings to the federal government would equal $100 million in 1995 and $1.7 billion over five years. These savings would be achieved primarily by reducing the appropriations for operation and maintenance, with minor additional savings from military construction.

Subsidies would not be reduced in remote locations where alternative recreational facilities are unavailable in the civilian community. A reduction in appropriated support of 50 percent should leave enough government funds available to support facilities in such locations. According to DoD, appropriations spent in remote locations totaled $160 million in 1992, or only about 17 percent of the total subsidy.

A reduction in MWR subsidies would force DoD either to discontinue some activities or to increase its reliance on user fees. The department might be given the flexibility to decide which activities to close and which fees to adjust. In a time of declining budgets, for example, DoD might decide that there is little need to maintain separate and expensive activities when civilian counterparts are readily available in nearby communities. Such activities might include fitness centers, libraries, bowling alleys, and movie theaters.

Most of the reduction in funding under this option could be realized from Category A activities. For instance, about 30 percent of the appropriated support for Category A programs is for physical fitness. To help defray the costs of providing these kinds of facilities, military members could pay monthly fees similar to membership charges in civilian health and fitness clubs. Or if civilian health clubs were convenient to an installation, DoD might be able to subsidize military memberships at lower cost than maintaining its own separate system.

This option would provide substantial savings during a time of ever-tightening budgets. It would also force the department to improve further the efficiency of its MWR activities by reducing operating costs in order to minimize the need for raising user fees. Presumably, DoD would eliminate some activities that could not be supported by user fees and cut its support for others or discontinue them.

This option does have drawbacks, however. If DoD elected to continue to provide some services but imposed user fees to pay for them, it could incur administrative costs associated with collecting the fees. These added administrative costs are not reflected in the savings estimates for this option.

Moreover, MWR activities are considered part of the military compensation package, and as such, any price increases could have detrimental effects on recruiting and retention. Furthermore, reductions in its budget and forces have prompted DoD to consider changes in many other programs that support military members and their families. Among the most prominent of these programs is military health care, which will be affected both by changes internal to the Department of Defense and by those resulting from Congressional consideration of national health care reform. (For a discussion of some of these issues, see DEF-27, DEF-28, DEF-32, and DEF-33.) A continual erosion of such benefits could lead to serious morale problems, which (as DoD would argue) could harm readiness. Finally, there is considerable Congressional support for family-related programs in general, so changes in these programs might be made only if the Congress is convinced of the availability of alternatives in the civilian community.

DEF-35 REDUCE FUNDING FOR U.S. FORCES STATIONED ABROAD

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	0	1,940	3,990	4,090	4,210	14,230
Outlays	0	1,410	3,270	3,820	4,040	12,540
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	0	1,480	3,040	3,120	3,200	10,840
Outlays	0	1,070	2,490	2,910	3,080	9,550

The Congress has repeatedly expressed its frustration at the unwillingness of allied nations to pay more of the costs of stationing U.S. forces in those countries. As illustrations of this concern, the conference reports on both the defense authorization and appropriation acts for 1993 called for increases in host nation support. Both committees urged that the United States renegotiate agreements about such support with its allies similar to the one with Japan; when that agreement is fully phased in, Japan will contribute 75 percent of the costs of stationing U.S. forces in that country (excluding U.S. personnel costs). The conference report on the defense authorization act for 1994 urged that these negotiations be intensified.

To provide incentives for both the Department of Defense and host nations to negotiate such agreements, the conference report on the 1993 defense authorization act cut $500 million in funds for stationing U.S. troops abroad. The conference report on the 1993 defense appropriation act cut $250 million in funds to support U.S. bases in Europe and prohibited obligation of an additional $175 million until the Secretary of Defense notified the Congress that negotiations with the European allies had yielded increased contributions. The conference report on the 1994 defense authorization act limited the funds used to support U.S. bases overseas to about $17.5 billion.

The Congress, of course, cannot mandate that other countries increase their contributions, but it can reduce the burden on U.S. taxpayers from stationing troops overseas. This option assumes that the Congress reduces funding for foreign stationing costs to a level consistent with general acceptance by host nations of additional obligations similar to those of Japan. Allied nations hosting major concentrations of U.S. forces--Italy, Germany, the United Kingdom, Spain, Belgium, the Netherlands, Iceland, Portugal, Turkey, and South Korea--would make up the difference or the United States would cut either forces or readiness. To allow time for the United States to conclude negotiations with these nations, this alternative would phase in the funding cuts over two years beginning in 1996. Reducing funding in this manner would save a total of $10.8 billion over the 1995-1999 period compared with the Administration's plan and $14.2 billion compared with the CBO baseline. Reflecting current law, the savings assume a limit of 100,000 troops stationed in Europe; the number of troops stationed elsewhere is assumed to remain at its current level.

Persuading U.S. allies to increase significantly their support as host nations may be difficult. Lower security threats may have reduced the importance of supporting foreign troop deployments on their soil. Also, many U.S. allies are currently experiencing recession or sluggish economic growth

that crimps their ability to increase government spending. Moreover, all major U.S. allies spend a greater percentage of their gross domestic product on defense than does Japan. Therefore, other U.S. allies might feel unduly pressured by negotiations aimed at raising their support to Japan's levels, which could lead to less friendly relations with these nations.

If other nations refuse to increase their support of U.S. forces, the United States could still realize the savings assumed under this option by withdrawing its troops and demobilizing them. (Because costs are incurred to base forces in the United States, simply bringing the troops home from overseas without reducing military forces eliminates most or all of the savings.) Withdrawing U.S. forces from abroad and demobilizing them, however, could in some cases lessen the ability of the United States to respond to crises rapidly.

Alternatively, savings could be realized by reducing funding for defense programs without cutting forces. In that case, a likely outcome would be some degradation in readiness, depending on how DoD chose to respond to the funding reduction. That degradation would affect overseas forces and could also affect stateside units. Reductions in readiness or modernization also could adversely affect the ability of U.S. forces to deploy quickly.

Either method of achieving savings would threaten the status and capability of U.S. forces stationed abroad. This prospect might give both the Department of Defense and the host countries sufficient incentive to reach new agreements that increase the contributions of those nations.

DEF-36 ADOPT SHORT, UNACCOMPANIED TOURS FOR EUROPE

	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
	Savings from CBO Baseline and CBO Estimate of Administration's Plan					
Budget Authority	240	240	240	400	410	1,530
Outlays	220	220	210	370	400	1,420

Under current policy, military personnel in Europe generally remain for tours of three years and may be accompanied by their families. The U.S. government pays for the moving expenses of dependents (spouses and children) and for other costs associated with their stay in Europe. In 1990, about 310,000 military personnel were located in Europe along with some 317,000 dependents. By 1993, the number of military personnel in Europe had decreased to 167,000 with a similar number of dependents. Accompanied tours require that DoD maintain a large support infrastructure in Europe, including schools for dependents, commissaries, hospitals, family centers, and family housing. In countries like South Korea, where housing shortages and other factors make it difficult to support families, most personnel are assigned for only one year without their families.

This option assumes adoption of one-year unaccompanied tours in Europe for almost all U.S. military personnel assigned there. Longer, accompanied tours would still be permitted for a few key personnel who need to remain overseas longer to ensure continuity in U.S. operations. This change would be phased in over three years, starting in 1995. When fully in effect, the new policy should permit elimination of all overseas schools for dependents, family centers, family housing, and some commissaries and other support facilities. The added costs associated with moving military personnel more often would be offset by savings in other areas. Together, these actions would reduce overseas support costs by $240 million in 1995 and by a total of $1.5 billion through 1999, compared with costs under the CBO baseline. This option is consistent with the Clinton Administration's plans to limit U.S. troops in Europe to 100,000 by 1995 and to maintain the current troop level in Korea.

Additional savings not reflected in these estimates might eventually be realized if the number of hospitals and other facilities that cater to dependents can be reduced. However, there could be greater costs, also not reflected in the estimates, for federal Impact Aid for schools in U.S. localities where military dependents would increase in number.

This option would primarily affect personnel in the Army and Air Force, who accounted for more than 90 percent of U.S. military personnel in Europe at the end of 1993. Even though many--perhaps as many as half--of the positions in Europe could be filled by unmarried personnel, the shift to short, unaccompanied tours would increase the portion of married Army and Air Force personnel serving without their families. By 1997, that share would rise from today's level of about 8 percent to about 12 percent, which is the current level for Navy and Marine Corps personnel. However, the share of Army personnel serving without their families would be almost double current levels, but still only one-third higher than the rates typical for Navy personnel.

Coupled with the increased disruptions associated with the ongoing drawdown of U.S. military forces, this increase in time away from their families might cause some Army and Air Force personnel to leave the military. Although such departures would be unlikely to cause shortages of skilled personnel during the current drawdown, lower reten-

tion could be a problem in the future. Shorter tours would also increase turnover among personnel in Europe, which could adversely affect readiness by reducing the amount of time units train together. Finally, some headquarters or support positions could require the continuity provided by longer tours.

Some of the problems associated with shorter tours could be minimized by the force drawdown or policy changes. The Congress has mandated a reduction of troops in Europe of about 65 percent between 1990 and 1995, compared with the 25 percent decrease in overall forces. As a result, fewer military personnel will face the prospect of unaccompanied tours, thus reducing any negative effects on retention. To counter the effect of higher turnover on readiness, entire units rather than individuals could be rotated; in this way, individuals would already be accustomed to operating as a unit. Finally, for those positions that require continuity, longer accompanied tours could be permitted with special provisions for educational and other support.

Adverse effects of unaccompanied tours would be further reduced if U.S. forces in Europe were cut even more. Some military analysts and policymakers have suggested that 50,000 or 75,000 U.S. military personnel in Europe may be adequate in view of the greatly diminished threat to European security posed by the republics of the former Soviet Union. Moreover, if only a small force was stationed in Europe, the per capita cost of maintaining schools, commissaries, and other support facilities would grow sharply, thereby encouraging a shift to unaccompanied tours.

DEF-37 REDUCE AND RESHAPE DOD'S CIVILIAN WORK FORCE

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Savings from CBO Baseline						
Budget Authority	1,130	3,330	5,530	7,920	10,520	28,430
Outlays	820	2,650	4,750	7,050	9,550	24,820
Savings from CBO Estimate of Administration's Plan						
Budget Authority	360	1,060	1,860	2,980	4,350	10,610
Outlays	260	850	1,590	2,600	3,870	9,170

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The civilian work force of the Department of Defense provides support services to military forces that range from payroll administration to maintenance of weapon systems. In 1992, DoD's civilian work force was 3 percent smaller than in 1982. In contrast, the active-duty military that the civilians support had shrunk by 12 percent. On average, each DoD civilian supported 1.9 military personnel in 1992, compared with almost 2.1 in 1982. Under the Clinton Administration's plan, that ratio is projected to fall still further by 1994, to 1.8.

At the same time that the number of military personnel whom civilian workers support has fallen, the average pay grade of DoD's white-collar civilian work force increased by one full grade (from just below GS-8 to nearly GS-9) between 1982 and 1992. This growth has been concentrated in supervisory grades (GS-13 through GS-15) and midlevel grades (GS-10 through GS-12).

Between 1994 and 1999, this option would gradually reduce and reshape DoD's civilian work force to restore the ratio of military to civilian support personnel to 2.0--the level characteristic of the 1980s--and reduce the grade creep of the last decade. By 1999, DoD's civilian work force would decrease by 196,000 under this option (from 923,000 in 1994 to 727,000 in 1999) compared with a reduction of 129,000 under the Administration's plan.

This option reduces civilian employment levels by 21 percent between 1994 and 1999. The Administration plans to reduce civilian employment by 14 percent in that period. CBO's baseline, however, assumes a continuation of the 1994 level of employment with no reductions in the future. Because CBO's baseline assumes a higher level of employment than that planned by the Administration, savings from reducing civilian employment are greater in comparison with the CBO baseline than in comparison with the Administration's plan.

Compared with the Administration's plan, this option would reduce civilian personnel costs in the federal budget by about $360 million in 1995 and $10.6 billion through 1999. Like the Administration's plan, this option assumes a reduction of 50,000 in the number of civilian workers in 1995. Savings in this option in 1995 assume that DoD adopts policy changes to lower average grade levels, thus reducing the grade creep of the 1980s. In fact, half of the savings between 1995 and 1999 are a result of lowering average grades.

The additional reductions assumed in this option could be accomplished by continuing a partial civilian hiring freeze that would limit replacements to roughly one of every two civilian employees who leave voluntarily. The 1993 defense authorization act also gave DoD new authority to offer monetary incentives to civilians affected by the defense draw-

down; these incentives are designed to induce civilians to resign or to take regular or early retirement. If DoD used cash incentives to achieve one-quarter of the additional separations proposed in this option, savings in the total federal budget would be reduced by $1.4 billion over the five-year period. Using these incentives would minimize the number of layoffs but would also substantially reduce DoD's immediate and long-term savings. The savings in this option do not reflect the use of separation incentives.

To reverse grade creep, DoD would need to slow the rate of promotions and rehire at the lowest grade level appropriate to the position. The needed personnel reductions might concentrate on management and administrative positions, which grew by 33 percent (from 143,000 to 190,000) during the 1980s, rising as a share of the work force from 15 percent to almost 20 percent. This option would restore the grade distribution existing in 1987, the peak year for civilian employment.

This option is consistent with recommendations of the National Performance Review (NPR) that call on all federal agencies to streamline headquarters and reduce overhead and supervisory personnel. DoD has already adopted a wide variety of management reforms, including the consolidation of common support services (for example, centralization of finance and accounting administration) and a large number of smaller efficiency measures. And DoD, like other agencies, may adopt additional streamlining measures to carry out these NPR reductions.

To achieve the cuts assumed in this option, DoD would have to be more aggressive in carrying out the recently adopted management reforms as well as make significant efforts to reorganize and reduce other support activities consistent with the smaller work load generated by fewer military forces. This option would also be analogous to Congressional direction in 1991 requiring DoD to reduce both military and civilian headquarters personnel by 20 percent between 1991 and 1995 to match overall reductions in the size of the military. The Congress has voiced considerable concern about DoD's inability to reduce overhead consistent with reductions in force structure.

Some analysts and policymakers might argue that the size of the civilian work force cannot be expected to fall at the same rate as that of the active-duty military, as this option assumes. Proportional cuts may be particularly difficult to achieve in the short term because some civilian functions--such as maintaining buildings and grounds on military installations or supporting a unit--will decrease only when a building or base is closed or a unit is disbanded. Other types of support are reduced only when the work load falls below a certain point (for example, if class size is 20, one instructor fewer is needed when the number of students falls by 20). For that reason, the reductions in this option would be phased in gradually; savings associated with excess management and support personnel are assumed to precede those associated with operating fewer facilities or reorganizing activities to reflect reductions in work load.

Attempting to restore the ratio of military personnel supported by each civilian worker to that of the 1980s could also jeopardize the quality of support services that civilians provide. Changes in that ratio may in fact reflect changes in the type of services they provide. Little evidence of such a change over the last decade exists, however; in fact, the occupational makeup of the civilian work force has been relatively stable.

Although the decrease in the civilian work force might not keep pace with the reductions in military forces in the short term, it should adjust in proportion to the size of the military force in the long term if support functions are reorganized to reflect changes in work load, particularly when reductions are predictable and carried out gradually. In addition, the size of DoD's infrastructure is decreasing, which should aid in attaining civilian cutbacks. For example, some military installations are being closed or realigned in accordance with the recommendations of three Presidentially appointed commissions on base closure, and more facilities are likely to be closed in the future.

DEF-38 RECOVER THE FULL COST OF MILITARY EXPORTS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	240	340	380	380	380	
Outlays	170	290	360	370	380	1,5[illegible]

The United States now exports more military equipment and services than any other country, a position held by the former Soviet Union during the 1980s. U.S. exports have expanded in part because of subsidies introduced by the Reagan and Bush Administrations. But economic concerns rather than Cold War competition have now become the primary motivation for arms sales, and with the end of the Cold War, the need to subsidize global alliances has greatly diminished. Indeed, Russia has terminated most of its grant agreements and now pursues arms exports as a means of earning hard currencies.

This option would reinstate a policy of full cost recovery to U.S. foreign military sales programs by reversing recent changes in U.S. laws and regulations. If the government recovered the full cost of arms sales, its additional receipts would save $240 million in 1995 and $1.7 billion over five years compared with the CBO baseline. The baseline assumes some decline in new arms sales agreements compared with recent levels, as other countries focus on sustaining existing weapon systems. Lower subsidies are estimated to have little effect on sales. The Administration has restructured its request for financing the sale of military equipment and services. CBO does not have sufficient detail to estimate savings relative to the Administration's plan.

Specifically, this option would eliminate several different subsidies now provided for foreign arms sales. It would reimpose charges--dropped in the last days of the Bush Administration--for nonrecurring research, development, and production on licensed commercial exports of major defense equipment. That would recoup some of the U.S. government's investment. In addition, the option would require that the cost of administrative services include the full cost of civilian and military personnel who work on foreign military sales. Finally, the option would eliminate all U.S. government financing of military sales except for those to Israel and Egypt.

Proponents of subsidizing military exports argue that the exports forge important ties between the United States and foreign military leaders. They also contend that having U.S. equipment would facilitate joint operations involving U.S. and foreign forces. Exports are also an important source of business and employment for defense industries. Advocates of arms sales claim that each billion dollars of exports supports 20,000 to 25,000 jobs in defense industries.

Opponents counter that concerns over the proliferation of weapons outweigh the benefits of protecting the defense industrial base. They contend that military exports contribute to destabilizing local arms races, increasing the destructiveness and violence of regional wars. Any beneficial effects on the defense industrial base, they believe, are offset by the drain of resources away from commercial investment.

This option takes no position on the merits or demerits of arms sales programs. It notes only that U.S. defense industries have significant advantages over their foreign competitors and thus should not need additional subsidies to attract sales. Because the U.S. defense procurement budget is nearly twice that of all Western European countries combined, U.S. industries can realize economies of scale not

available to their competitors. The U.S. defense research and development budget is five times that of all Western European countries combined, which assures that U.S. weapon systems are and will remain technologically superior to those of other suppliers. The military and political ties with the United States associated with the sales are also an important benefit to many foreign countries. No other country can offer the same military or logistical assistance in times of crisis as the United States.

Perhaps most important, the elimination of government subsidies might encourage discussions about nonproliferation with other arms exporters. By demonstrating the threat posed by regional conflicts, the Persian Gulf War generated calls for new approaches to controlling the proliferation of conventional weapons, especially within the Middle East. The United States began a series of discussions with the other permanent members of the United Nations Security Council with the intention of establishing a mechanism of notification and consultation to curtail destabilizing arms sales to that region. Those discussions faltered when China ended its participation following the United States' sale of F-16 fighter aircraft to Taiwan. As these events suggest, promoting arms sales for economic reasons can have serious diplomatic and security implications that may outweigh economic concerns.

DEF-39 REDUCE STATE DEPARTMENT FUNDING AND ELIMINATE MISCELLANEOUS FOREIGN AFFAIRS ACTIVITIES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Savings from CBO Baseline						
Budget Authority	140	230	300	310	320	1,300
Outlays	110	190	260	290	310	1,160
Savings from CBO Estimate of Administration's Plan						
Budget Authority	120	120	120	60	0	420
Outlays	100	110	120	70	10	410

The Department of State, which employs about 25,000 full-time personnel in the United States and in foreign countries, promotes U.S. foreign policy interests abroad. Other, smaller agencies also conduct research and activities relating to foreign affairs. Compared with the CBO baseline, this option would reduce State Department funding by $1 billion over the 1995-1999 period and would save an additional $300 million by eliminating the related functions of various other agencies dealing in foreign affairs. Compared with the Administration's plan, which is substantially lower than the CBO baseline, this option would save about $420 million over the five-year period.

The State Department will receive about $2.6 billion in 1994 to administer its foreign affairs programs. In the 1980s, this portion of the State Department's budget averaged $1.6 billion. Inflation was responsible for some of the increase, but the funding that was added to provide security for diplomats and to establish new posts in the republics of the former Soviet Union also contributed. Even when funding for added security and new posts is excluded, however, real growth from the 1980s through 1994 amounts to about 10 percent. The increases in funding mainly reflect growth in salaries and related expenses and in rental and acquisition costs of residences and office space.

The State Department is not the only federally funded organization that works on foreign affairs activities. Smaller agencies such as the U.S Institute of Peace, the Asia Foundation, the East/West Center, and the North/South Center perform functions that could be eliminated without directly affecting U.S. foreign policy. These agencies, which have combined budgets totaling about $60 million annually, conduct research and work to build better relations between the United States and various foreign countries.

This option would keep State Department funding at its 1994 level from 1995 to 1997 and then allow funding to increase with inflation in later years. Relative to funding under the CBO baseline, which assumes that funding remains constant in real (inflation-adjusted) terms at its 1994 level, this funding profile would yield savings totaling $80 million in 1995 and about $1 billion over the five-year period. By 1997, State Department funding (excluding the cost of security improvements and new posts in the former Soviet Union) would return to its average real level of the 1980s. The department could accommodate these cuts by eliminating or consolidating posts in less important areas of the world, by reorganizing the State Department bureaucracy, and by reducing the number of senior foreign service officers, which some studies have suggested is too high given the size of the foreign service. These changes would make the State Department more efficient and able to operate at a lower funding level. This option also would eliminate funding for the smaller agencies dealing in foreign affairs.

Compared with the CBO baseline, funding would fall by about $60 million in 1995.

Opponents of this option would argue that more money--not less--will be needed to handle the new, complex issues that the United States now faces abroad. The current number of senior foreign service officers may be needed to represent the United States in the post-Cold War world in which economic superpowers will compete. Finally, the smaller agencies dealing in foreign affairs might be viewed as providing valuable independent analysis of issues and improving the United States' understanding of, or relations with, foreign countries.

DEF-40 REDUCE DEVELOPMENT ASSISTANCE

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	330	370	380	390	400	1,870
Outlays	40	240	310	350	370	1,310

The Agency for International Development (AID) administers development-related projects and provides technical advice in 92 developing countries. Since the creation of AID in 1961, the United States has spent $118 billion on development assistance. AID and its programs have been criticized, however, for waste and ineffectiveness. This option would markedly scale back AID and the programs it administers, thereby allowing the agency to focus on more attainable goals in those countries most likely to benefit from U.S. development assistance. Reducing development assistance along the lines suggested below would save $330 million in 1995 and $1.9 billion over the five-year period, relative to the CBO baseline. The Administration is proposing to rewrite the Foreign Assistance Act of 1961 and has structured its budget request accordingly. The Administration has not provided sufficient detail on its plan for CBO to estimate savings from this option.

Two decades ago, the last major revision of the Foreign Assistance Act directed AID to focus on four objectives: alleviating poverty, fostering economic growth, encouraging respect for civil and economic rights, and integrating developing countries into an international economic system. Since then, the Congress has added more than 30 new objectives that range from promoting biodiversity to reducing urban pollution. Reports issued by AID, as well as by the Congress and independent commissions, have stated that AID has too many objectives and supports projects in too many countries. These reports recommend that AID narrow its focus and fund fewer projects with more attainable goals.

Some critics of assistance offer an even harsher assessment. They contend that even if U.S. development assistance programs were properly managed and targeted, the resulting improvement in economic development would be marginal. These critics argue that countries whose economies have grown steadily have typically not achieved this growth through the use of foreign assistance but by adopting economic policies that promote free markets and trade. Furthermore, some analysts contend that because the performance of the U.S. economy affects the economies of developing countries, a healthy U.S. economy is the best type of development assistance the United States can provide. With a healthy economy, U.S. consumers will buy more imports from developing countries, thereby creating wealth and promoting markets and trade in those countries.

This option would limit the number of countries in which AID operates. It would eliminate development assistance to about 30 middle-income countries and would also terminate aid to those lower-income countries in which U.S. assistance has shown no results. As a result of these changes, AID would be providing assistance to fewer than 60 countries, compared with 92 countries today. Its assistance would target lower-income countries that have economic policies designed to encourage growth through free markets and trade.

In addition, this option would narrow the scope of the agency's funding by providing assistance only to programs that focus on alleviating poverty and promoting economic development. In particu-

lar, it would eliminate the housing investment guarantee (HIG) program, which arguably is inconsistent with other U.S. objectives. The HIG program provides high-interest, hard-currency loans to developing countries for housing. A decade after the recognition of the international debt crisis, the United States is not helping recipient countries by extending hard-currency loans to them for an activity that does not generate the foreign exchange needed to retire the debt.

Other programs would be shifted to agencies whose mission is closer to the objective. For example, private enterprise activities would be shifted to the Overseas Private Investment Corporation, and transnational concerns, such as the environment, would be devolved to the domestic agency dealing with the issue in the United States. These shifts would reduce the AID budget but would not affect total government spending.

Opponents of these reductions would argue that AID has technical expertise that the developing world finds valuable. Despite the mixed success of AID projects, its supporters contend that the United States should continue to fund development assistance programs in a large number of countries because many problems that developing countries face cannot be solved by the free market alone. Among these problems are environmental pollution, the spread of the acquired immune deficiency syndrome, and immigration and refugee problems. These problems are international in scope and thus affect the United States. Opponents of cutting development assistance might argue that it is a foreign policy tool that can help solve these problems and ultimately help the United States itself. Finally, U.S. aid might be justified on purely humanitarian grounds.

DEF-41 ELIMINATE P.L. 480 TITLE I SALES AND TITLE III GRANTS

	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Savings from CBO Baseline			
Budget Authority	640	660	680	690	710	3,380
Outlays	350	620	670	680	700	3,020
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	470	470	480	480	480	2,380
Outlays	260	450	470	480	480	2,140

The Agricultural Trade and Development Act of 1954 (P.L. 480) was enacted during a period when the inconvertibility of foreign currencies and the lack of foreign exchange held by potential customers limited commercial exports of large domestic surpluses of agricultural commodities. Sales for foreign currencies, concessional credit, and grants provided a mechanism for developing markets, disposing of surplus commodities, and furthering U.S. foreign policy interests.

Changes in the world over the past 40 years may have rendered the program obsolete, however, and it may now be an inefficient means of achieving each of these objectives. This option would eliminate sales under Title I and grants under Title III, reducing the federal budget by $640 million in 1995 and $3.4 billion over five years relative to the CBO baseline. Savings would be somewhat smaller relative to the Administration's plan. Humanitarian and emergency feeding programs are funded under Title II of P.L. 480 and under section 416 of the Agricultural Act of 1949 and would not be affected by this option.

The market development aspect of the P.L. 480 program is relatively insignificant for two reasons: exports under Titles I and III are a small portion of total U.S. agricultural exports, and the countries currently receiving P.L. 480 commodities are unlikely to become commercial customers. In fiscal years 1956 through 1965, the P.L. 480 program financed between one-quarter and one-third of all agricultural exports. Since the mid-1960s, the value and tonnage of shipments under Titles I and III have declined as commercial exports have grown. In 1993, these shipments represented less than 2 percent of the $43 billion in total agricultural exports. U.S. security or foreign policy interests largely determine which countries receive commodities under Titles I and III. To the extent that market development is still an objective of U.S. policy, it should focus on countries that are likely to become commercial customers in the near term. Other programs such as the Commodity Credit Corporation's short- and intermediate-term credits and the Export Enhancement Program are designed to protect old markets and to penetrate new markets at lower cost to the U.S. government.

Disposing of surpluses is no longer a primary concern of the program. The government no longer holds stocks of most of the commodities shipped under P.L. 480; they are managed instead through the Acreage Reduction Program. Any exports lost by eliminating Titles I and III could be counterbalanced by lowering production through an increased acreage set-aside, which would not build surpluses or affect the budget.

In some cases, the terms of credit granted under Title I of P.L. 480 may actually harm the economies of the countries that receive the credits. Credits under Title I have maturities as long as 30 years, and thus the obligation for repayment remains long after the item purchased has been consumed. The

1990 amendments to P.L. 480 recognized this problem and authorized the cancellation and reduction of old loans that had become a burden to the economies of the recipient nations.

Finally, providing assistance to developing countries through P.L. 480 is not always an efficient use of U.S. resources. Many of the U.S. agricultural commodities that foreign countries buy with P.L. 480 assistance are resold to generate local currencies. These funds are used in turn to support local budgets and local development. But the inexpensive food may discourage local investment in agriculture, may lower rural incomes, and may discourage the development of local stockpiles. To the extent that one or more of these effects occurs, the United States has hindered local development.

These drawbacks notwithstanding, Titles I and III of P.L. 480 also have their supporters who argue that the programs are a flexible, fast means of providing assistance to friendly countries. They point out that the programs also reduce the likelihood that surpluses of agricultural commodities will depress prices within the United States and that they offer some humanitarian benefits: agricultural products are shipped, and hungry people are fed.

DEF-42 ELIMINATE OVERSEAS BROADCASTING AND REDUCE EXCHANGE PROGRAMS

	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Savings from CBO Baseline			
Budget Authority	-20	240	630	720	740	2,310
Outlays	-90	220	580	710	730	2,150
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	10	100	470	550	550	1,680
Outlays	-60	70	440	540	550	1,540

U.S. overseas broadcasting is provided by several entities. Radio Free Europe (RFE) and Radio Liberty (RL) broadcast country-specific news to Eastern Europe and the former Soviet Union, respectively. The United States Information Agency (USIA) oversees television broadcasting services and the Voice of America (VOA) radio broadcasts that provide news and U.S.-related information to audiences worldwide. The USIA also manages a broadcasting service to Cuba. In addition, the USIA administers educational and cultural exchange programs, in which U.S. citizens travel to foreign countries and foreign citizens come to the United States to learn about the other country's institutions and culture. Terminating overseas broadcasting and reducing the size of exchange programs would save approximately $2 billion over the 1995-1999 period.

The Clinton Administration has proposed consolidating certain broadcasting services by combining RFE/RL and VOA and scaling back their operations. According to Administration estimates, its proposal will save $400 million by the end of 1997. This option would instead close VOA and RFE/RL, would end broadcasting services to Cuba, and would reduce funding for exchange programs by 30 percent compared with baseline levels. Such reductions in exchange programs would eliminate all real growth that occurred between 1991 and 1994. The option would also end all overseas construction of broadcast facilities and would end U.S. overseas television broadcasting. When measured against the CBO baseline, closing RFE/RL and VOA, which have annual operating budgets of about $225 million each, would cost about $175 million in 1995 but would save about $1.3 billion over the five-year period. Over the five-year period, ending broadcasts to Cuba would save about $100 million; terminating construction of broadcast facilities would save $400 million; and stopping U.S.-sponsored television broadcasts would save about $120 million. Near-term savings for these programs are reduced by large termination costs, such as severance pay for employees. This option assumes a reduction of 30 percent in funding for exchange programs, leading to savings of a further $390 million in 1995 through 1999. Compared with the Administration's plan, which is lower than the CBO baseline because of the proposed consolidation, this option would save $1.7 billion over the five-year period.

Proponents of terminating overseas broadcasting claim that RFE/RL and VOA are relics of the Cold War that are no longer necessary. RFE and RL continue to broadcast to countries of Eastern Europe and the former Soviet Union even though, after the fall of communism, these countries have ready access to world news. With the advent of satellite television broadcasting, most nations can receive world and U.S.-related news from private broadcasters, such as the Cable News Network (CNN). Some proponents also argue that the primary technology used by VOA and RFE/RL limits the effectiveness of U.S. overseas broadcasting; because shortwave radios are needed to receive most broadcasts, audi-

ences are limited. Finally, foreigners may distrust the accuracy of U.S.-sponsored broadcasts.

Critics of this option would argue that the current level of broadcasting should continue or even increase. The process of change in Eastern Europe and the former Soviet Union needs nurturing, and U.S. broadcasting can assist in that process. In other parts of the world, many countries remain closed. Supporters of VOA and RFE/RL argue that shortwave radio broadcasts are the best way to reach people in closed countries because very few people own satellite dishes, which are needed to receive television broadcasts such as those by CNN. They also note that VOA and RFE/RL are continuing to broadcast more programs over AM and FM frequencies. Supporters also argue that broadcasting should be sharply increased to some countries, such as China and North Korea. Further, they believe that television is a powerful communications tool and that private television networks cannot adequately communicate U.S. policy and viewpoints.

Funding for U.S.-sponsored exchange programs has grown by about 30 percent in real terms between 1991 and 1994. Critics of the programs argue that some of this growth may have been unnecessary because as increased communication and private travel make the world a smaller place, the need for exchanges decreases.

Advocates of exchange programs argue that exchanges provide participants with a unique perspective and an in-depth knowledge of foreign cultures and institutions. As the United States continues to build stronger economic and political ties with foreign countries, this knowledge, they argue, is invaluable and funding for exchange programs should therefore be increased, not decreased.

DEF-43 REDUCE EXIMBANK'S CREDIT ASSISTANCE

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
			Savings from CBO Baseline			
Budget Authority	510	530	540	560	570	2,710
Outlays	50	180	300	400	450	1,380
			Savings from CBO Estimate of Administration's Plan			
Budget Authority	290	170	160	140	130	890
Outlays	30	90	120	140	140	520

The Export-Import Bank (Eximbank) promotes U.S. exports by providing financing to foreign buyers of U.S. goods. The bank makes direct loans with below-market interest rates and provides guarantees of private lending without receiving full compensation for the contingent liability of future losses. The U.S. exporter and the foreign buyer share these subsidies. In the 60 years since its creation, Eximbank has lost $8 billion on its operations, practically all in the past 15 years. Baseline projections of new subsidy costs for Eximbank are $1 billion per year.

This option would cut the subsidy appropriation in half, saving $510 million in 1995 and $2.7 billion through 1999 relative to the CBO baseline. Savings would be more modest compared with the Administration's plan. To ease the impact that reduced funding would have on exports, the bank could raise risk-related fees and ration its budgetary resources to sales that would not go forward without government-assisted financing.

Eximbank's credit assistance is driven by demand. The bank provides assistance on a first-come, first-served basis and tries to meet all requests for assistance. Supporters of Eximbank call for ever-larger funding levels to meet exporters' desires for subsidized credits. But U.S. exports are not increased if the bank is substituting for private-sector financing. The bank could avoid such substitution by targeting specific regions underserved by private-sector financing.

Supporters of Eximbank say that the subsidies it provides offset subsidies provided by foreign governments and that eliminating them would put U.S. exporters at a disadvantage. These subsidies, they argue, increase U.S. exports, thereby providing jobs to U.S. workers. The bank also plays an important role in encouraging the participation of small businesses in export markets. Finally, supporters claim that the bank's subsidies help to increase the output of high-technology industries and allow them to achieve economies of scale.

Critics of Eximbank dispute these claims. The bank, they point out, extends credit assistance to parties other than exporters facing foreign-subsidized competition. And little evidence exists suggesting that the credit creates jobs. Finally, since the United States encourages the creation of free-market economies throughout the world, providing subsidies to promote exports is contrary to the free-market policies the United States advocates.

DEF-44 REDUCE SECURITY ASSISTANCE

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Savings from CBO Baseline						
Budget Authority	120	290	450	580	700	2,140
Outlays	90	210	360	480	600	1,740
Savings from CBO Estimate of Administration's Plan						
Budget Authority	70	180	290	350	410	1,300
Outlays	50	130	230	290	360	1,060

Security assistance, which includes funds for both military aid and economic support, is an important means of advancing the interests of U.S. national security and foreign policy. In 1994, funding for security assistance totaled $5.5 billion.

This option would reduce security assistance, saving $120 million in 1995 and $2.1 billion in 1995 through 1999 compared with the CBO baseline. Compared with the Administration's plan, savings would be somewhat smaller. These savings would be achieved through measures described below. Because Israel and Egypt receive the largest shares of security assistance--totaling over 90 percent, or $5.1 billion, in 1994--the reductions would fall heavily on them.

Although the United States has provided assistance to Israel for decades, the high level of cash payments to Israel from the Economic Support Fund dates from the Camp David Accords of 1979. Since 1984, the Congress has promised to provide Israel with sufficient funds to repay Israel's debts to the U.S. government. The assistance was justified as providing the material support required to maintain Israel's security. It also constituted an expression of U.S. support that was intended to give Israel the confidence to pursue meaningful peace negotiations. That justification has not changed, even though the regional peace process stalled shortly after the Camp David Accords were signed and progress was not restarted for a dozen years. Nor has U.S. security assistance led to self-sustaining growth in the Israeli economy. Indeed, critics have argued that the cash payments have eased the pressure within Israel to undertake painful policy reforms, creating a relationship of dependency on the United States. Rather than increase U.S. influence, this outcome has generated its own friction. In practice, U.S. aid to Israel exceeds the amount needed to repay outstanding loans and loan guarantees for security assistance. Relative to the CBO baseline, the United States could save $70 million in 1995 and nearly $1.3 billion over the next five years and still keep its promise by limiting cash payments to the level of loan repayments.

Economic assistance to Egypt is also associated with the Camp David Accords. Egypt was isolated from the other Arab nations after signing the peace treaty with Israel. The high level of U.S. assistance was justified in order to sustain Egypt's military forces, which faced hostility from other Arab states, and to maintain popular support by addressing Egypt's short- and long-term development needs. More recent justifications call for maintaining a strong and stable Egypt with close ties to the West and encouraging political and economic liberalization; but in practice, the funding level for Egypt is closely tied to the level of assistance to Israel. Critics note that high levels of appropriations have exceeded Egypt's ability to spend the funds, leading to the accumulation of large undisbursed balances, inefficient use of assistance, and delays in the reforms needed to foster self-sustaining economic growth. If aid to Egypt was cut in proportion to the

cuts in aid to Israel described above, savings would total $50 million in 1995 and almost $870 million over the next five years.

Cuts in economic support for Israel and Egypt are not the only examples of potential reductions, though they may be the most likely area for cuts over the next few years. The two countries also receive $3.1 billion per year in foreign military financing (FMF), which also could eventually be reduced. Some critics argue that U.S. military sales and arms transfers to the Middle East, including FMF for Israel and Egypt, have contributed as much to sustaining a regional arms race as to regional security. Others have argued that the sophisticated weapon systems that the United States is financing will burden Israel's and Egypt's economies with their high maintenance and support costs. Nevertheless, this option does not assume reductions in FMF because both Israel and Egypt have obligated themselves to purchase military equipment that will be paid for out of future appropriations--a practice known as cash flow financing. At current levels of FMF, the next year's worth of Israel's grants have already been obligated, as have the next three and one-third years' worth of Egypt's. Thus, reductions in FMF could be achieved only at the cost of canceling commitments that both countries have already entered or by forcing Israel and Egypt to reallocate funds from other programs to make up for the FMF cuts.

Opponents of reducing security assistance to Israel and Egypt argue that U.S. interests in the region have not diminished and that any cut would send the wrong signal at the wrong time. Despite recent improvement in its bilateral relations with the Palestinians, Jordan, and Morocco, Israel remains in the midst of difficult peace negotiations with its Arab neighbors. Any reduction in assistance might be viewed by all parties as a weakening of U.S. support for Israel and interest in peace in the region, perhaps terminating the very peace process that the United States has carefully nurtured over the past two years. Israel is also bearing the extraordinary burden of absorbing 500,000 migrants over four years from the former Soviet Union while also attempting to move toward a more open market economy. Arguably, it can ill afford any reduction in external financing for the next three to five years without jeopardizing both efforts.

Egypt's need for development assistance is also great. The level of economic assistance to Egypt, though high, is lower than it was a decade ago in real terms and has remained stable for the past five years. Egypt is also continuing to undertake much-needed policy reforms such as reducing subsidies and relaxing price controls; a reduction in security assistance now could send the wrong signal.

Chapter Three

Domestic Discretionary Spending

Domestic discretionary programs include all those funded through appropriations except programs in defense and international affairs. An extremely varied category results, comprising such topics as science and space, transportation, energy, agriculture, environmental protection, housing, education and training, medical research, and law enforcement (see Box 1).

Since 1980, the category has declined as a share of federal outlays despite a recent rise in spending permitted under the Budget Enforcement Act of 1990 (BEA). The decline has led some observers to suggest that further reductions in domestic discretionary spending will contribute little in additional savings for reducing the deficit and that now there is less reason to explore additional cuts in spending. But pressures to increase spending for a variety of perceived national needs--which have been intensified by the natural inclination of a still relatively new Administration to reorient the country's priorities--are creating new demands on the budget. The search for programs that are outmoded or unneeded remains an important task, because reductions in spending will still be necessary in some areas to "pay for" increases in others. Moreover, some Members of Congress are dissatisfied with the level of deficit reduction achieved in 1993 and continue to seek new options to reduce the deficit more quickly.

Spending for domestic discretionary programs will total an estimated $243.7 billion in 1994, or about 17 percent of federal outlays. This level represents a $17.1 billion--or 7.5 percent--increase over domestic discretionary spending in 1993. The 1994 increase is particularly significant because the limits on spending imposed by the BEA and continued under the Omnibus Budget Reconciliation Act of 1993 (OBRA-93) permit only a $1.8 billion increase in total discretionary spending. (That category of spending is a larger grouping that includes spending for discretionary international and defense programs in addition to spending for domestic programs.) Given that spending for international programs is also estimated to grow in 1994, it becomes apparent that most of the increase in spending for domestic discretionary programs is coming from decreases in spending for defense. Relative to the nation's gross domestic product (GDP), spending in the domestic discretionary category has risen since the enactment of the BEA, moving from 3.3 percent in 1990 to an estimated 3.7 percent in 1994 (see Figure 2).

Despite the increase in overall spending for domestic discretionary programs in 1994, the Congress faced difficult choices in allocating funds within the category. It exercised spending restraint in many areas in order to fund new initiatives or provide larger-than-average increases for current programs. As a part of that effort, it adopted several of the options for reducing domestic discretionary spending that were included in last year's deficit reduction volume. In the area of space and science (budget function 250), the Congress moved to curtail spending for several large space science efforts and canceled the Advanced Solid Rocket Motor and the Superconducting Super Collider programs. It also discontinued postal subsidies for not-for-profit and other organizations (function 370, commerce and housing credit). The Homeownership and Opportunity for People Everywhere (HOPE) grant program received a diminished appropriation, and no funds were appropriated for special-purpose grants by the Department of Housing and Urban

Box 1.
Categories of Domestic Discretionary Spending

250 General Science, Space, and Technology--Research supported by the National Science Foundation, the bulk of the spending by the National Aeronautics and Space Administration, and the general science research supported by the Department of Energy.

270 Energy--Domestic energy programs of the Department of Energy and activities of the Rural Electrification Administration and the Nuclear Regulatory Commission, including programs to increase the supply of energy, encourage energy conservation, provide an emergency stockpile of energy, and regulate energy production.

300 Natural Resources and Environment--Programs administered by the Army Corps of Engineers, the Department of Agriculture, the Department of the Interior, the Environmental Protection Agency, and the Department of Commerce's National Oceanic and Atmospheric Administration, among others, for water resources, conservation and land management, pollution control, and other natural resources programs.

350 Agriculture--Programs administered by the Department of Agriculture to promote economic stability in agriculture and increase agricultural output. Farm income stabilization--loans, subsidies, and other payments to farmers--and agricultural research are funded under this function.

370 Commerce and Housing Credit--Funding for the regulation and promotion of commerce and the housing credit and deposit insurance industries. Also included in this category are subsidies to the Postal Service, programs providing loans and other aid to small businesses, and support for the government's efforts to gather and disseminate economic and demographic data.

400 Transportation--Most of the programs of the Department of Transportation and the National Aeronautics and Space Administration's support for aeronautical research, including funding to aid and regulate ground, air, and water transportation. Among the prominent programs supported under this function are grants to states for highways and airports and federal subsidies to Amtrak.

450 Community and Regional Development--Programs that support the development of physical and financial infrastructure intended to promote viable community economies, including activities of the Department of Commerce and the Department of Housing and Urban Development. This function also includes expenditures to help communities and families recover from natural disasters and supports the rural development activities of the Department of Agriculture, the Bureau of Indian Affairs, and other agencies.

500 Education, Training, Employment, and Social Services--Funding for a diverse group of education and training programs extending from the preschool level (the Head Start program, for example) to elementary and secondary education (grants to states, for instance) to postsecondary education and vocational training. Most of the programs included in this category are administered by the Departments of Labor and Education.

550 Health--Research (in the form of grants, largely to universities) supported by the Department of Health and Human Services through the National Institutes of Health, and programs funded by several different federal agencies to promote food and drug safety, consumer product safety, and occupational safety.

570 Medicare--The administrative expenses of the program, which are classified as discretionary. (Medicare provides health care services to people ages 65 and older and to disabled beneficiaries.)

600 Income Security--Housing assistance administered by the Department of Housing and Urban Development and other major discretionary programs including assistance to needy individuals for food and energy.

700 Veterans Benefits and Services--Funding for the veterans' hospitals and the construction of veterans' health facilities.

750 Administration of Justice--Programs that provide judicial services, law enforcement, and prison operation. The Federal Bureau of Investigation, the Customs Service, the Drug Enforcement Administration, and the federal court system are all supported under this function.

800 General Government--Funding for the central management and policy responsibilities of both the legislative and executive branches of the federal government. The bulk of the expenditures in this category cover legislative functions and central fiscal operations, including those of the General Services Administration and the Internal Revenue Service.

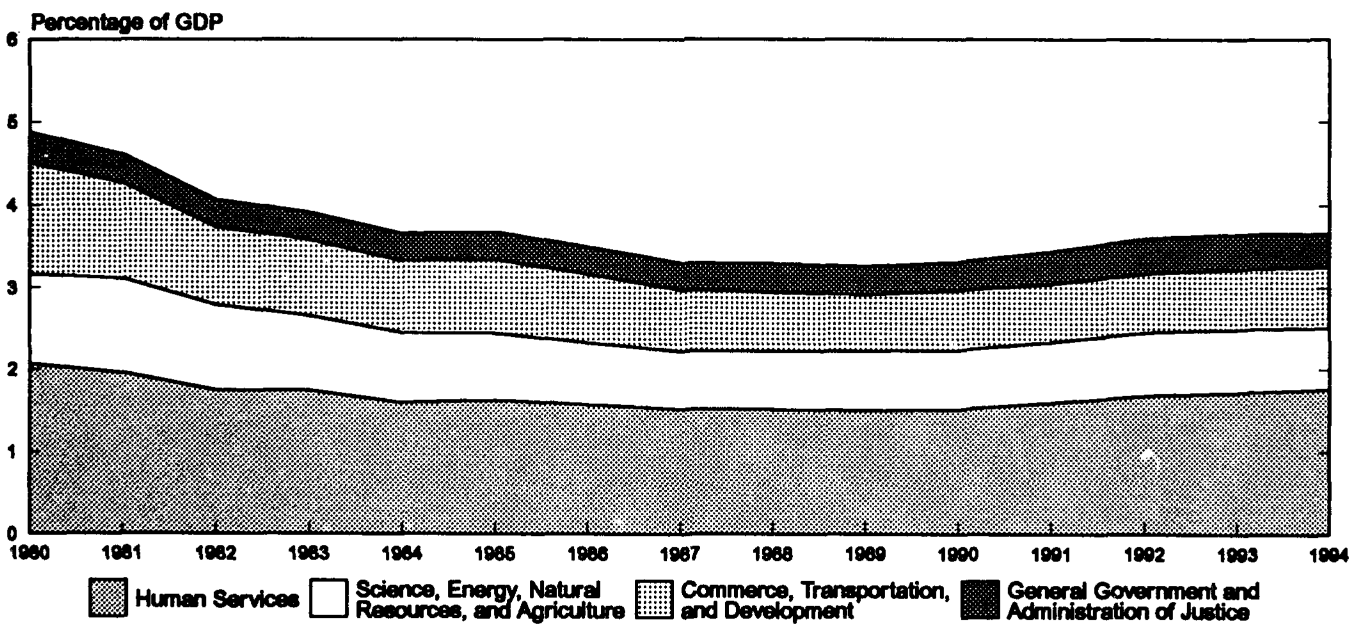
SOURCE: General Accounting Office, *A Glossary of Terms Used in the Federal Budget Process* (January 1993), pp. 103-126.

Development (function 600, income security programs). The Congress also adopted an option to use income data from the Internal Revenue Service to identify unreported income of households receiving rent subsidies (function 600).

The competition for funds is likely to intensify in 1995. A highly likely priority is improving the standing of U.S. producers in world markets by supporting more federal spending for research and development with commercial potential. Additional funding could be sought to help states preserve wetlands and control the run-off pollutants from farms, urban areas, and construction sites in the nation's rivers. Pressures to improve the national highway system are ever present, as are calls to solve the problems of housing and homelessness. Moreover, the Administration advocates increased funding for the Head Start preschool program. Improving the nation's educational system could also require increases in funding to support states in financing new initiatives to reform schools and adopt national standards and tests for elementary and secondary education. Greater federal support for cures for the acquired immune deficiency syndrome (AIDS) and other diseases is advocated by many people. And given that crime is reportedly the issue of most concern to the electorate, it is not difficult to foresee any number of new demands to increase spending for law enforcement, prisons, and rehabilitation.

The OBRA-93 spending limits for 1995 require a $1.7 billion reduction in total discretionary spending compared with 1994. Decreases in defense discretionary spending may be sufficient to pay for growth in domestic discretionary spending, but the pace and the ultimate size of the reduction in spending for defense remain contentious. In addition, the Administration's proposals to increase spending for some domestic programs continue to exert upward pressure on spending for this category.

Figure 2.
Domestic Discretionary Spending as a Share of GDP



SOURCE: Congressional Budget Office.

Consequently, the Congress is likely to continue to explore options that decrease spending for some domestic discretionary programs.

Because all of the options in this chapter affect discretionary spending, achieving the budgetary savings they offer requires legislation in the form of appropriation acts. In some cases, however, the options describe changes in the laws establishing the programs, in addition to reductions in the amounts appropriated for them. The reduction in the appropriation--rather than the change in the program--causes spending to decline. That aspect of discretionary spending contrasts with options affecting entitlements or mandatory programs, which are discussed in Chapter 4, in which reductions in appropriations generally are not needed to produce budgetary savings.

In contrast to options that involve changes in appropriations, the options that propose alterations in authorizing legislation change the goals of a program or the methods of achieving them. An example of *such an option is* DOM-10, which would reduce the level of cleanup required in the Superfund program. The effect of the program change, combined with reduced appropriations, would be different from the effect of cuts in appropriations alone.

The text accompanying each option contains a description of the programmatic changes and their effects, and arguments for and against the changes. The estimated savings for each option are calculated from an uncapped baseline, in which the assumed appropriations for 1995 through 1999 equal the 1994 amounts adjusted for inflation. By contrast, the CBO baseline assumes that total discretionary appropriations in 1995 are limited by the caps in the BEA and appropriations for 1996 through 1999 are limited by the caps enacted in OBRA-93.

Several of the options contained in this chapter would affect spending in both the mandatory and discretionary categories established by the BEA. An example is DOM-07, which would eliminate below-cost timber sales in national forests. In this option, receipts from timber sales, which fall into the mandatory category, would be reduced, but the loss of receipts would be more than offset by lower discretionary funding for Forest Service activities.

Six options would affect spending for defense as well as for domestic discretionary programs. DOM-58 focuses on federal support for computer hardware and software. DOM-59 and DOM-60 would change rules that apply to government labor contracts. DOM-54 and DOM-55, which pertain to the current compensation of civilian federal employees, would also affect discretionary spending for both domestic and defense programs, as would DOM-56, which proposes reductions in the number of political appointees.

Federal budget functions define the order of the options in this chapter. DOM-01 addresses a reduction in space and science programs (function 250). DOM-02 through DOM-15 analyze reductions or changes in federal support and management of energy, natural resources and the environment, and agriculture (functions 270, 300, and 350). DOM-16 through DOM-21 cover commerce and housing credit (function 370). DOM-22 through DOM-26 describe options for transportation programs (function 400). DOM-27 through DOM-31 deal with community and regional development (function 450). DOM-32 through DOM-44 focus primarily on education and health (functions 500 and 550). DOM-45 through DOM-49 concentrate on housing and income security programs (function 600). DOM-50 relates to veterans' programs (function 700). DOM-51 through DOM-53 center on the administration of justice (function 750). The final set of domestic discretionary options, DOM-54 through DOM-60, would decrease domestic discretionary spending in more than one budget function.

DOM-01 CANCEL THE INTERNATIONAL SPACE STATION PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	2,150	2,200	2,250	2,350	2,400	11,350
Outlays	1,400	2,100	2,250	2,300	2,350	10,400

Canceling the space station would save $1.4 billion in 1995 and $10.4 billion from 1995 through 1999. During 1993, cumulative spending on the space station surpassed $9 billion, and the orbital facility underwent the seventh and eighth redesigns of its nine-year life. The Congress devoted considerable attention to the project during 1993, affirming its support in six separate votes during the calendar year.

Currently, the Administration is proposing a space station program that would broaden international participation by adding Russia to the project. (Current participants are the United States, Canada, Japan, and the member nations of the European Space Agency.) Russia would contribute hardware--either selling or leasing equipment to the United States--and launch services; it would also have an ongoing operational role, carried out by the Russian Space Agency. The National Aeronautics and Space Administration (NASA) estimates that the Russian configuration, as the current design for the space station is called, will require $15 billion in funding between 1995 and 2001 to be fully developed, launched, and operational by the end of that period.

Advocates of canceling the international space station program contend that the benefits of the project are unlikely to justify its costs. In support of their position, critics cite the general lack of support for the program among individual scientists and scientific societies. The program's opponents also note that the cost of the program has continually increased, although its capabilities and scope of activities have decreased. NASA claims that the Russian configuration reverses past trends of rising costs and shrinking capabilities and that the new design will deliver more space station for less money. But the accuracy of the agency's cost estimates is questionable because the design is not fully developed and NASA's accounts for the space station program do not show the full cost of the project. Furthermore, critics point to the uncertainty surrounding the costs of operating and supporting the facility once it has been developed and launched. On that score, opponents of the program are skeptical of NASA's assurance that the station's operating costs will be low, noting that the agency made similar claims that proved overly optimistic about the space shuttle.

Advocates of spending for the space station program continue to emphasize the importance of its effects on employment in the aerospace industry at a time when declining defense budgets are reducing the demand for the industry's products and services. Supporters of the space station also argue that the Russian configuration adds a strong foreign policy reason for continuing the program. They assert that drawing Russia, and particularly its aerospace industry, into a cooperative venture will help to stabilize the Russian economy and provide incentives for Russia to adhere to international agreements concerning the spread of missile technology. Supporters of the space station further note the long-standing arguments about the value of the project as a laboratory in orbit with unknown but positive scientific potential and as a test-bed to learn how people in space live and work, in anticipation of future piloted exploration of the solar system. Advocates of the program point out that its cancellation would force the United States to renege on agreements signed with European nations, Japan, and Canada. That withdrawal would hurt the prospects for future international cooperative agreements on space, science, and other areas of mutual interest.

DOM-02 REDUCE DEPARTMENT OF ENERGY FUNDING FOR ENERGY TECHNOLOGY DEVELOPMENT EFFORTS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Reduce Fossil Energy R&D						
Budget Authority	65	130	200	280	360	1,035
Outlays	25	80	150	250	300	805
Reduce Nuclear Energy R&D						
Budget Authority	35	75	110	160	200	580
Outlays	20	45	85	140	170	460
Reduce Energy Conservation R&D						
Budget Authority	40	85	130	180	230	665
Outlays	10	45	90	170	180	495
Reduce Fusion and Solar and Renewable Energy R&D						
Budget Authority	60	130	200	270	340	1,000
Outlays	30	80	140	230	290	770
Total, All Programs						
Budget Authority	200	420	640	890	1,130	3,280
Outlays	85	250	465	790	940	2,530

The U.S. Department of Energy (DOE) and its predecessors have been funding technology development projects for several different energy sources since the first oil crisis in 1973. Despite two decades of spending, few successful energy technologies have emerged from these research and development (R&D) programs. Given this lack of success, DOE could cut back on programs for near-term development of energy technologies and instead concentrate its efforts on basic and applied science in these fields.

Spending for new energy technologies can be reduced in a number of ways; the table at the top of this page presents the savings associated with four such options. The estimates assume that funding for fossil energy R&D and funding for nuclear energy R&D are reduced to 25 percent of their baseline levels and that the reductions are phased in over the 1995-1999 period. Energy conservation, magnetic fusion, and solar and renewable energy R&D programs are all reduced to 50 percent of their baseline levels, phased in over the same five years. In total, these reductions could save $85 million in outlays in 1995 and $2.5 billion over the 1995-1999 period.

The justification for adopting each of these options rests primarily on the appropriate division of labor between federal programs and related activities in the private sector. In many instances, embarking on large-scale technology development projects may be premature: supporting basic and applied science projects instead would allow a better understanding of the phenomena at issue before trying to harness them to a technology. In several

areas, DOE has a comparative advantage in developing the basic and applied science around a new energy source but is at a comparative disadvantage in the costly technology development and demonstration phases. Federal agencies like DOE lack the sensitivity to see when a new technology is too expensive (or esoteric) for commercial purposes.

Arguments have been advanced to support each of the reduction options. In the area of fossil energy R&D, the first option in the table, commercial firms already spend a great deal of money to develop new technologies. The major new technologies for enhanced oil recovery, for example, have come from private industry, not DOE. In other instances, DOE continues to develop technologies in which the market clearly has no interest. As an illustration, DOE spent hundreds of millions of dollars on coal-powered magnetohydrodynamics--without any indication of who was interested in the product. (This option does not include the Clean Coal Technology Program, which is covered separately in DOM-03.)

For the second option, nuclear energy R&D, the wisdom of pursuing new technologies is questionable as long as electric utilities, the intended recipients, have no interest in new nuclear plants. (Their lack of interest may rest in part on the fact that national policy for addressing nuclear wastes remains undeveloped.) DOE has spent close to $9 billion on nuclear fission R&D since 1978 and has little in the way of commercial applications to show for its investment. Moreover, policymakers recently began to open the electricity generation market by obliging utilities to buy electricity from a group of suppliers. Given those circumstances, it may be time to let the newly opened market encourage the private sector to develop its own technology.

Energy conservation R&D, the third option, comprises many projects that are small and discrete enough--and have a clear enough market--to warrant private investment. In such cases, DOE may be crowding out private actors or, alternatively, conducting R&D that those private actors are likely to ignore--a common fate of the technology generated within DOE's national laboratories. Furthermore, spending for energy conservation has almost doubled since 1990. (Energy conservation R&D funds are distinct from technical and financial assistance programs, which would not be included in this option.)

For the fourth option, which deals with magnetic fusion and solar and renewable energy R&D, commercial markets for these technologies may be years, if not decades, away, and large-scale technology demonstration projects may be premature. In some cases, the technology is being pursued before the scientific phenomenon is completely understood. Moreover, solar and renewable energy R&D spending has almost tripled since 1990.

Proponents of these programs argue that energy markets are still far from perfect and that consequently federal intervention is still justified. The utilities area, for example, remains bounded by a wide array of federal and state regulations; those controls might distort the incentives facing private firms that want to undertake the R&D for a new technology. Supporters also note that progress is certainly being made, although it has taken more time than planners originally estimated to develop new energy sources. Researchers note as well that government-supported R&D allows national goals to be met, an outcome that the private sector would not necessarily pursue. For example, if the integral fast reactor can be successfully developed, it will burn radioactive wastes as fuel, thereby mitigating the nation's disposal problem while being inherently safer than current reactors.

Given the reduction in DOE's programs for developing nuclear weapons, cuts in energy R&D may be difficult to make. Many in DOE and the Congress are counting on such civilian spending to help in converting DOE's R&D personnel and facilities from military to commercial uses. Cutting these energy R&D programs would leave fewer conversion alternatives for DOE's R&D infrastructure. In response, however, it could be argued that going from one unneeded federal program to another would not be a helpful economic conversion.

As an alternative to eliminating these programs, the Congress could preserve technology development activities in those cases in which private industry was willing to share in the full burden--not just with a token percentage of the cost, as is now

true for many programs. That strategy would conserve those programs that stood a chance of moving into commercial development but still help DOE with its military-to-civilian R&D conversion process. Some current DOE programs, most notably in energy conservation and nuclear energy R&D, are already using that approach.

DOM-03 ELIMINATE FURTHER FUNDING FOR THE CLEAN COAL TECHNOLOGY PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Budget Authority	0	0	155	160	160	475
Outlays	0	0	0	a	20	20

a. Less than $2.5 million.

The Clean Coal Technology Program (CCTP) was created in 1984 to assist private industry in developing commercial technologies that would use coal in environmentally sound ways. After five rounds of bid solicitations, the Department of Energy (DOE) will spend over $2.7 billion to fund and administer selected CCTP projects. The government's spending on these demonstration projects is limited to 50 percent of total costs. This option would complete projects already selected in rounds one through five of CCTP bid solicitations but eliminate any future funding for projects. Savings would total less than $20 million in projected outlays over the 1995-1999 period.

An initial goal of the CCTP was to reduce acid rain by supporting technologies that could lower the emissions of sulfur dioxide (SO_2) and nitrogen oxides (NO_x) that result from coal combustion. President Reagan declared that his Administration would honor an agreement with Canada to spend $2.5 billion on clean coal technologies aimed at helping curb acid rain in Canada. Other important goals of the program have been to promote the use of coal to replace imports of crude oil and to bolster the economies of coal-producing regions. Concerns about global warming and emissions of carbon dioxide have recently whetted policymakers' interest in increasing the efficiency of coal use.

Current practices that reduce SO_2 and NO_x emissions include cleaning the coal before burning it, scrubbing combustion gases to remove sulfur, switching to types of coal with a lower sulfur content, and switching to other fuels altogether. The new technologies that the CCTP supports fall into three general categories:

- Retrofit technologies that lower harmful emissions from existing coal-fired plants by cleaning the coal before combustion, reducing the level of gases emitted during combustion, or removing (or scrubbing) the gases emitted from combustion;

- Repowering technologies that replace all or part of existing boilers with advanced combustion systems that both reduce emissions and increase power output; and

- Conversion technologies that change coal into a liquid or gas.

Most of the CCTP-funded projects will demonstrate technologies to retrofit or repower coal-burning electricity generating plants.

Federal support for new clean coal technologies may no longer be necessary. In the past, supporters of the CCTP viewed it as an alternative to legislation controlling acid rain: the enactment of ill-timed controls could force industry to invest in current, high-cost abatement technologies when new, low-cost ones might be just around the corner. Since the passage of the Clean Air Act Amendments of 1990, however, the private sector has faced a clear legislative mandate for lowering coal emissions. Electric utilities and large industrial users of coal now have a clear economic motive for selecting from among current practices and new

technologies the lowest-cost options for reducing emissions. DOE efforts may also be redundant in the light of independent research efforts by utilities themselves and by states that produce high-sulfur coal and want to maintain the product's sales. Moreover, the energy security benefit of increased coal use would be negligible, because coal today substitutes for oil in very few applications.

Alternatively, continued CCTP funding could hasten deployment of control and abatement technologies that would provide social benefits beyond what electric utilities would be willing to pay for under the Clean Air Act Amendments. Those benefits could come in the form of cleaner air and economic support for electricity consumers in general and for coal-producing regions in particular.

DOM-04 HALT ACQUISITIONS OF CRUDE OIL FOR THE STRATEGIC PETROLEUM RESERVE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	0	0	0	0	0	0
Outlays	80	80	80	80	5	325

The Strategic Petroleum Reserve (SPR) was authorized in 1975 by the Energy Policy and Conservation Act to reduce the vulnerability of the United States to interruptions in oil supplies. Under plans developed in the 1970s, the SPR is a government-owned crude oil inventory, stored mainly in salt caverns in Texas and Louisiana. This option would halt all purchases of oil for the SPR and rescind any unspent funds for acquisitions. As a consequence, the SPR fill rate would drop from an initial rate of about 13,000 barrels per day in 1994 to zero by early 1999. The option would save $80 million in outlays in 1995 and $325 million over the 1995-1999 period.

Current law establishes a fill target for the SPR of 1 billion barrels, but that target has never been vigorously pursued. Through fiscal year 1993, 586 million barrels of crude oil were stored in the SPR, and only 14 million barrels of oil were added during that year. In 1991, the Department of Energy (DOE) even sold approximately 20 million barrels from the SPR as part of a coordinated international response to the United Nations' embargo of oil from Iraq and occupied Kuwait.

At the end of fiscal year 1994, DOE will have approximately $250 million in unspent funds for purchasing oil for the SPR. With these funds, DOE could support oil acquisitions of more than 12,000 barrels per day for about four years. The CBO baseline assumes no new DOE appropriations for the SPR in 1995 because there were none in 1994.

The principal advantage of this option is the savings in short-term costs. In addition, the option would not greatly diminish the nation's readiness to meet energy emergencies. If DOE spent all of the oil-purchasing funds that it had available, the SPR would contain about 610 million barrels by the end of 1999. With acquisitions halted after 1994, the reserve would still contain about 590 million barrels by that time.

A disadvantage of the option is that the final bill for filling the SPR may be greater as a consequence of delaying acquisitions. (DOE's forecasts for oil prices over the long term--that is, beyond CBO's five-year projections--indicate significantly rising prices.) And although the total amount of oil in the SPR at the end of 1999 under this option would not be too different from the level of purchases supported by the CBO baseline, it would still be short of the target of 1 billion barrels by that additional amount.

DOM-05 ALLOW PRIVATE PRODUCERS TO COGENERATE ELECTRICITY AT FEDERAL CIVILIAN FACILITIES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Budget Authority	0	0	30	30	30	90
Outlays	0	0	10	25	30	65

Over the years, the Department of Defense has entered into agreements with private power producers to build and operate cogeneration facilities at some of its installations. Those facilities provide electricity and heat to the installations and then sell off any excess electricity they produce to private users. Cogeneration conserves energy because power plants produce heat and electricity at the same time and from the same energy source. But Title VIII of the Shared Energy Savings Amendment of the National Energy Conservation Policy Act of 1978 restricts power plants at nondefense federal installations from making similar arrangements.

Allowing private utilities to cogenerate electricity at the government's civilian facilities could save $65 million in outlays through 1999. Civilian federal agencies--primarily the Department of Energy but also the National Aeronautics and Space Administration, the General Services Administration, and the Department of Veterans Affairs--could avoid the cost of rebuilding aging plants that provide steam to heat buildings and power industrial processes. Additional savings--not included in the table--could result from lower utility costs to agencies if the private providers operating the cogeneration facilities sold steam and electricity at lower rates than the agencies now pay. The Administration included this proposal in its National Performance Review.

Proponents of the proposal note that it reduces federal outlays while increasing electricity generating capacity and conserving energy. The new cogeneration facilities would be more efficient than current facilities. But achieving this efficiency requires that private producers be allowed--as they would be under this option--to sell off-site any excess electricity they generate. Even federal facilities with steam plants that do not need rebuilding could lower their heating and electricity costs by allowing private developers to build and operate cogeneration facilities.

A disadvantage of this proposal is that some utilities that now provide electricity to federal civilian agencies might well object to losing a portion of their business; in addition, under the Public Utility Regulatory Policies Act, they would be required to buy excess power from the new cogeneration facilities. The total amount of power involved, however, is not large, and the effect of this option on utilities would vary greatly--depending on both cost factors and the price-setting rules used by public utility commissions. Some utilities might welcome the new source of power, but others with sufficient generating capacity for their needs might resent having to make required purchases of electricity from the cogeneration facility.

DOM-06 ELIMINATE CREDIT SUBSIDIES PROVIDED BY THE RURAL ELECTRIFICATION ADMINISTRATION

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	90	90	100	100	100	480
Outlays	10	30	50	80	90	260

The Rural Electrification Administration (REA), an agency within the Department of Agriculture, provides financial assistance in the form of subsidized loans and grants to electric and telephone companies that primarily serve rural areas. For 1994, REA subsidies total about $90 million, and grants constitute $10 million in spending authority. In addition, REA spends nearly $40 million per year administering these programs. Eliminating the credit subsidies for loans made or guaranteed by the agency would reduce outlays by an estimated $10 million in 1995 and $260 million between 1995 and 1999.

Most REA borrowing was established in the 1930s, 1940s, or 1950s. Many communities served by those borrowers are now much larger than the original service-area requirement of no more than 1,500 inhabitants. In total, the agency's borrowers serve about 10 percent of the nation's electricity consumers and about 4 percent of its telephone customers.

REA credit subsidies were reduced by more than one-half from 1993 to 1994, reflecting the significant changes in the program enacted in the Rural Electrification Loan Restructuring Act of 1993. Moreover, because federal borrowing costs have declined significantly in the past few years, the average subsidy provided for REA's low-interest (5 percent) loans has also declined. Before passage of the 1993 act, most REA borrowers were eligible for 5 percent loans. Under the restructured program, some borrowers are still eligible for the 5 percent loans; others may borrow from the agency at slightly higher (although still subsidized) rates; and still others may borrow either at the rate that the Treasury pays to borrow or 7 percent, whichever is less.

Although the appropriation for the cost of subsidies for all REA lending declined from about $200 million in 1993 to about $90 million in 1994, the agency will still make new loans totaling close to $1 billion this year--slightly less than the level in 1993. Gross lending has been maintained at this level because some loans will be made at higher interest rates than others and interest rates on federal borrowing have declined. Together, those factors translate into a lower average subsidy for REA loans.

The savings shown in the table would result from either of the following two scenarios: discontinue lending and require REA borrowers to use private sources of capital for all their loan needs, or continue a federal loan program but eliminate subsidies. An REA loan program with no subsidy costs would require raising the interest rates on loans to the level of the Treasury's cost of borrowing; it would also mean charging small loan origination fees to cover the cost of defaults for certain classes of loans. In addition to savings in subsidy costs, some savings in administrative costs could be achieved if REA lending was discontinued. Some of REA's nearly $40 million per year in salaries and expenses would be required to administer existing loans, but those costs could be gradually reduced under the no-new-lending option.

The REA has largely fulfilled its original goal of making electric and telephone service available in rural communities. Yet many borrowers still de-

pend on REA loans to maintain and expand such services. Increasing the interest rates or charging loan origination fees on some loans would raise the utility rates charged by REA borrowers, especially for the rural regions most affected. REA borrowers argue that they need some level of subsidization to keep their service and utility rates comparable to those in urban regions. Most REA borrowers already use some private financing, however. Because the cost of interest accounts for only a small percentage of the typical customer's bill, eliminating the remaining federal subsidy would have little effect on the utility rates that most borrowers charge their customers.

DOM-07 ELIMINATE BELOW-COST TIMBER SALES FROM NATIONAL FORESTS

Savings from CBO Baseline	1995	1996	1997	1998	1999	Cumulative Five-Year Savings
	Annual Savings (Millions of dollars)					
Discretionary Spending						
Budget authority	25	45	60	80	100	310
Outlays	20	40	60	75	95	290
Change in Receipts[a]						
Budget authority	-5	-5	-10	-15	-20	-55
Outlays	-5	-5	-10	-15	-20	-55
Total						
Budget authority	20	40	50	65	80	255
Outlays	15	35	50	60	75	235

a. These losses of receipts would be treated as increases in direct spending.

The Forest Service (FS) manages federal timber sales from 119 national forests in the national system. In 1993, the FS sold roughly 4.5 billion board feet of public timber under contract to private lumber companies. The total 1993 harvest, approximately 5.9 billion board feet providing about $900 million in federal timber receipts, represented a continued decline in volume from previous years. In 1993, the FS spent approximately $800 million on timber management, reforestation, construction of logging roads, payments to states, and other timber program costs, resulting in net federal timber receipts of $100 million.

In seven of the nine National Forest System regions, however, annual cash receipts from federal timber sales have consistently failed to cover the FS's annual cash expenditures. For example, in three of these so-called below-cost timber sale regions--the Rocky Mountain, Northern, and Intermountain--cash expenditures have exceeded cash receipts by a ratio of about 3 to 1 on average over the past decade. (Annual timber program costs in the three regions still exceed annual timber receipts if FS expenditures for road construction are excluded.) The FS does not maintain the data needed to estimate annual timber receipts and expenditures associated with each separate timber sale; it is therefore hard to determine precisely the budgetary savings that could be achieved by phasing out all below-cost timber sales in the National Forest System. As an illustration of the potential savings, however, eliminating all future timber sales from the three regions mentioned above would reduce FS outlays by $290 million over the 1995-1999 period, including savings in the timber road budget. Timber receipts would be reduced by about $55 million. Net savings in federal budget outlays over the 1995-1999 period would be about $235 million.

Below-cost timber sales have several potential disadvantages. They may lead to an increase in the federal deficit, wasteful depletion of federal timber resources through uneconomic harvests, unwarranted destruction of roadless forests valued by many recreational visitors, and government interference with private timber markets.

One advantage of the sales, however, is that the FS timber program generates other-than-financial benefits to the government. Among these are community stability in areas dependent on the federal timber industry for logging and other related jobs and increased access from road construction for fire protection and recreation. Community stability could be particularly important in light of current court injunctions--to protect the spotted owl--that have reduced harvesting activities in some areas.

The risk of economic hardship from eliminating the federal timber program in these areas could be reduced by gradually lowering the level of below-cost timber sales, by providing federal job replacement skills programs, and by encouraging greater development of other activities--such as tourism and recreation--in the national forests.

DOM-08 ABOLISH THE BUREAU OF MINES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	180	190	200	200	210	980
Outlays	120	170	190	200	200	880

Abolishing the Bureau of Mines (BOM) would reduce outlays by $880 million over the 1995-1999 period. Most of those savings come from eliminating jobs at BOM offices and research labs. Legislation phasing out the Mineral Institutes program, a relatively small part of the BOM, has already passed the House of Representatives following its proposal by the Administration.

Advocates of ending appropriations for the BOM point out that many of its original functions have been taken over by other agencies. (For example, the Department of Energy now collects data on minerals used for generating energy, and the U.S. Geological Survey provides information on reserves of minerals.) The BOM is limited to gathering information on hardrock minerals for public dissemination and conducting research on mining techniques. Those two functions could be handled by private companies.

Proponents of keeping the BOM open argue that the bureau also gathers and disseminates information about environmental and physical conditions at current and abandoned mining sites. Federal land managers concerned with the safety of users of federal lands or those affected by environmental hazards need that information to clean up hazardous sites. Another argument against the proposal is that federal land managers may need the bureau's services and expertise in the technologies for remediating abandoned mining sites to actually carry out some of that cleanup. (Liability laws discourage private companies from using remediation techniques on abandoned sites for which federal agencies are responsible.)

An alternative to shutting down the research activities of the BOM is to have the mining industry pay for their operations and maintenance. That plan would continue the research and information services that the bureau now provides.

This option includes discontinuing federal production of helium, which is an activity of the BOM. Begun in the 1920s to ensure adequate supplies, the federal effort now accounts for only about 10 percent of total U.S. production. Ending it would result in a small increase in the federal deficit because revenues from sales to nonfederal customers would be lost. Federal production facilities--worth about $20 million--could be sold, but those receipts are not included in the estimated savings. This option assumes that the Department of the Interior would maintain the federal helium reserve.

DOM-09 ELIMINATE FEDERAL GRANTS FOR WASTEWATER INFRASTRUCTURE AND STATE REVOLVING FUNDS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	2,550	2,600	2,700	2,750	2,800	13,400
Outlays	95	720	1,600	2,200	2,500	7,115

Construction grants for wastewater treatment plants were first authorized in 1972 under the Title II categorical grant program of the Clean Water Act. The federal share under Title II was 55 percent of project costs, with localities not obligated to repay the money. Title VI, which was added to the act as part of the 1987 amendments, authorized a program of grants--through 1994--to capitalize state revolving funds (SRFs).

SRFs make low-interest loans to local public agencies to construct municipal wastewater treatment facilities that help attain and maintain high water-quality standards. For each dollar of Title VI money that a state receives, it must contribute 20 cents to its SRF. In 1994, nearly 95 percent of all money for construction of wastewater treatment plants under the Clean Water Act was appropriated to the SRFs. The remaining money went to fund the categorical grant program.

The Clean Water Act is now being considered for reauthorization. Under CBO baseline assumptions, federal support for the construction of local facilities for wastewater treatment is projected to continue at the 1994 level of $2.5 billion, adjusted for inflation. Ending all funding of new wastewater projects after 1994 would save approximately $95 million in 1995 and $7.1 billion through 1999.

Proponents of eliminating federal grants to SRFs argue that the program was intended to be temporary and may have replaced, rather than supplemented, state and local spending. They also point out that, in some cases, the grants may have encouraged inefficient treatment decisions by making it possible for SRFs to loan money at below-market rates of interest. Below-market rates could reduce incentives for local governments to find less capital-intensive and less costly alternatives for controlling water pollution.

Opponents of such cuts argue that states and localities would find it more difficult to meet the Clean Water Act's treatment deadlines without continued federal contributions because repayments to the SRFs would be insufficient to fund new projects and states would be unable to shoulder the additional cost of increased contributions to the SRFs. The U.S. Environmental Protection Agency estimated in 1991 that $110.6 billion in additional treatment facilities would have to be built over the next two decades for states to meet the current goals set by the Clean Water Act.

DOM-10 DE-EMPHASIZE PERMANENCE IN SUPERFUND CLEANUPS; EMPHASIZE LAND-USE CONTROLS AND CONTAINMENT METHODS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	420	430	440	340	310	1,940
Outlays	90	200	300	260	290	1,140

Estimates of the size of the nation's hazardous waste problem and of the resources required to resolve it have grown substantially since the Superfund program was established in 1980. The Environmental Protection Agency (EPA) expects to spend a total of $27.3 billion on cleaning up the first 1,248 sites on the National Priorities List (NPL), including $15.8 billion in fiscal years 1994 and beyond. Substantial related expenditures will be required by the Energy and Defense Departments and by other agencies responsible for federally owned hazardous waste sites. Moreover, new sites continue to be added to the NPL. A recent CBO study, *The Total Costs of Cleaning Up Nonfederal Superfund Sites* (January 1994), estimated that EPA's future Superfund costs may be between $35 billion and $130 billion, depending on the ultimate number of nonfederal NPL sites.

One way to reduce these large costs is to change the mix of methods used to protect health and the environment at Superfund sites. The present statutory preference for permanent treatment technologies could be dropped in favor of an emphasis on institutional controls (such as deed and access restrictions, monitoring, and provision of alternate water supplies) and containment methods (including caps, slurry walls, and surface water diversion). A University of Tennessee study estimated that a judicious shift toward these interim measures could reduce remediation costs by 40 percent, without sacrificing health or environmental protection. Such a shift would reduce federal expenditures for enforcement as well as for direct cleanup, since it would decrease the incentive for private parties to contest their hazardous waste liabilities. Given a reasonable transition period, Superfund outlays could be cut by $1.1 billion over the 1995-1999 period. Total budgetary savings would be higher if the new standards were applied to federally owned waste sites, or lower if Superfund taxes were reduced.

Proponents of this option argue that it is wasteful to spend more on Superfund cleanups than is necessary to protect health and the environment, and that use of more permanent remedies (such as incineration, bioremediation, and vitrification) can be deferred until land-use needs are clearer and treatment technologies are better developed. Opponents argue that the option may not provide as much protection as supporters claim, and that invoking it would be unfair to local communities (which would bear the disruptive effects of the land-use restrictions) and to future generations (which would bear any costs of replacing interim cleanups with more permanent measures). Some opponents also assert that the lion's share of cost savings from any significant reduction in remediation requirements should take the form of cuts in the taxes that provide the primary financing for the Superfund trust account; modifying the proposal in that way would substantially reduce the net benefit to the federal budget.

DOM-11 SUBSTITUTE PRIVATE FINANCING FOR GOVERNMENT FINANCING OF THE SUPERFUND PROGRAM TO THE MAXIMUM EXTENT POSSIBLE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	440	450	460	320	260	1,930
Outlays	90	190	290	230	240	1,040

The Superfund program to clean up the nation's worst hazardous waste sites makes four groups of "potentially responsible parties" (PRPs) liable for cleanup costs, damages to natural resources, and the costs of health-impact studies. The PRPs include a site's past and present owners and operators, the generators of its hazardous substances, and any transporters who selected the site as a disposal location.

This proposal would minimize the use of money from the Superfund trust fund for cleanup work; the fund would be drawn on only when the collective resources of a site's PRPs were insufficient to cover the total costs. Specifically, the Environmental Protection Agency (EPA) would forgo the option of funding a cleanup and then seeking reimbursement, and it would avoid PRP settlements that covered less than 100 percent of cleanup work and past costs. In some respects, the proposal merely extends EPA's current "enforcement-first" Superfund strategy by placing even more emphasis on leveraging private-sector dollars; however, it uses increased private spending as an opportunity to reduce federal expenditures rather than to increase the pace of the Superfund program.

The strongest version of this proposal includes short-term and emergency removal actions, as well as long-term remedial responses and their associated studies, in the definition of cleanup work. This variant would save $1.0 billion over the 1995-1999 period, assuming that Superfund tax rates remained unchanged, that 30 percent of the sites had no financially viable PRPs, and that the enforcement budget rose by 20 percent. (Increased expenditures on negotiation, litigation, and searches for PRPs would be offset to some extent by reduced efforts to recover costs.) Focusing more narrowly on remedial actions and their preliminary studies would reduce the five-year savings to $680 million.

Proponents of this approach argue that it would better reflect the "polluter pays" conception of fairness that is a guiding principle of the Superfund law, and that it would reduce the overall cost of hazardous waste cleanup by taking fuller advantage of the efficiency of the private sector. Opponents counter that further emphasis on leveraging private dollars is likely to be inefficient, given the impact on enforcement costs, and could increase the risks to health and the environment by delaying cleanup. They also contend that prohibiting the use of joint Superfund and PRP financing is unfair, given that sites may involve "orphan shares" associated with parties that are insolvent or that cannot be found, and that increases in private-party contributions should continue to be used to increase the pace of the program.

DOM-12 REDUCE FEDERAL SUPPORT FOR AGRICULTURAL RESEARCH AND EXTENSION ACTIVITIES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	170	180	180	190	200	920
Outlays	110	160	180	190	190	830

The Department of Agriculture (USDA) has three agencies that conduct and support agricultural research and education. The Agricultural Research Service (ARS), the USDA's internal research arm, operates at locations throughout the country; its research focuses on maintaining and increasing the productivity of the nation's land and water resources, improving the quality of agricultural products and finding new uses for them, and improving human health and nutrition. The Cooperative State Research Service (CSRS) supports agricultural research conducted at land-grant universities and other state institutions. The Extension Service (ES) introduces farmers to new technology and educates low-income families about good nutrition; the ES also provides some services to urban residents.

The 1994 appropriations for these three agencies totaled $1.7 billion. Reducing funding levels by 10 percent below the baseline would save $830 million in outlays during the 1995-1999 period.

Research grants provided by the ARS and CSRS may, in some cases, be replacing funding from the private sector. If the ARS and CSRS grants were eliminated in those cases, the private sector would be forced to finance more of its own research. Moreover, federal funding for some ES activities could be reduced without undercutting the service's basic mission of educating and assisting farmers. For example, funding for a Nutrition Education Initiative, the Nutrition and Family Education program, and Youth at Risk programs amounted to $76 million under the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 1994, or 17 percent of the overall appropriation for the ES.

Research and extension activities have long played important roles in developing an efficient farm sector--a reduction in federal grants could compromise the sector's development in the future and its competitiveness in world markets. If the burden of funding was transferred to the private sector, agricultural research, which helps provide U.S. consumers with an abundant, diverse, and relatively inexpensive food supply, could decline. Moreover, some federal grants are used to improve human, animal, and plant health by funding research that promotes better nutrition or more environmentally sound farming practices. If federal funding was cut back, the direct budgetary savings would be substantial, but the public could bear some of the cost in higher prices, forgone innovations, or environmental degradation.

DOM-13 STREAMLINE THE OPERATION OF FARM AGENCIES' FIELD OFFICES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	30	110	180	250	330	900
Outlays	30	110	180	250	330	900

The Department of Agriculture (USDA) has four agencies that use extensive networks of local field offices to administer farm programs. The Agricultural Stabilization and Conservation Service (ASCS) administers commodity and land-use programs. The Soil Conservation Service (SCS) directs the national soil and water conservation program. The Farmers Home Administration furnishes credit to farmers and other rural residents. The Extension Service provides a diverse range of educational services, including introducing farmers to new technology and to improvements in farming practices.

A 1991 report by the General Accounting Office (GAO) found that the ASCS and SCS have offices in more than 85 percent of the 3,150 counties in the United States, the Farmers Home Administration has offices in over 60 percent of the counties, and the Extension Service has offices in nearly all of the counties. Each agency employs state-level managers to oversee local operations. The GAO report concluded that this highly decentralized operational structure is inefficient and costly. The report recommended extensive administrative streamlining. It suggested that the USDA could improve efficiency and save money through the collocation and consolidation of field offices and through improvements in sharing resources. (Collocation involves two or more agencies sharing a common operating site; consolidation involves merging two or more field offices of a single agency into a single office.) Cost savings are realized when integrated field offices share administrative resources, structural facilities, personnel, equipment, and services.

Several proposals have been offered to reorganize and streamline the USDA's operations, particularly in the agencies that serve farmers directly. One such proposal calls for closing 1,200 local offices; it would also reorganize the department's headquarters, cutting the number of separate agencies and support staffs. The plan would eliminate 7,500 full-time positions throughout the USDA over a five-year period, about 90 percent of which would be in field offices. (The USDA employs nearly 115,000 full-time-equivalent workers, about 88 percent of whom are located outside of Washington, D.C.)

If the reductions in personnel were made and the administrative budgets were cut accordingly, this proposal could reduce agency outlays by $900 million over the 1995-1999 period. The majority of these savings are associated with reductions in salaries and benefits as positions are consolidated and eliminated. Additional savings stem from reductions in office overhead (rent and utilities) and personnel overhead (travel, supplies, and telephone service). Some of these savings are offset, however, by increased spending for severance and leave benefits and the costs of relocating employees and offices.

Critics of cutting field staffs and offices are concerned about the toll these reductions may take on the USDA's services to farmers. Moreover, if offices are closed, some farmers would have to travel farther to receive services.

DOM-14 REDUCE USDA SPENDING FOR EXPORT MARKETING AND INTERNATIONAL ACTIVITIES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	30	30	30	30	35	155
Outlays	25	30	30	30	35	150

The Department of Agriculture (USDA) runs programs to promote exports and international activities through the Foreign Agriculture Service (FAS) and the Organization for International Cooperation and Development (OICD). FAS develops foreign markets by jointly funding--with U.S. trade and commodity organizations called "cooperators"--overseas advertising campaigns, trade show exhibits, and promotional materials. OICD collaborates on a variety of ventures, one of which provides training to foreign nationals with the objective of improving commercial relationships that will benefit U.S. agriculture. Eliminating funding for these programs could reduce outlays by $150 million over the 1995-1999 period.

Although the cooperator program has served a useful purpose, it may be ready to revert to private enterprise, with no financial assistance from FAS. The program has tended to promote basic commodities, such as grains, oilseeds, and cotton. It is uncertain how much return in terms of market development the cooperator program is generating. In addition, private, brand-name advertising is sponsored in this program, and many people object to spending taxpayer money on such activities.

The OICD Cochrane Fellowship Program affords a select group of foreign midlevel managers a visit to the United States and training in agriculture and agribusiness. The benefits to U.S. agriculture are unknown, and although the program is popular among the recipients and their sponsors, it may be of marginal value to taxpayers.

Some observers maintain that U.S. agriculture, processors, and traders would suffer from less business abroad, especially over the long run, if funding for these FAS and OICD activities were cut.

DOM-15 REDUCE LOANS MADE BY THE FARMERS HOME ADMINISTRATION FOR FARM OWNERSHIP AND OPERATIONS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	80	80	90	90	90	430
Outlays	80	80	90	90	90	430

The Farmers Home Administration (FmHA) lends money directly to new farmers or farmers of limited means who cannot obtain loans elsewhere for purchasing land or materials to operate a farm. FmHA makes some of these loans at interest rates that approximate the Treasury's cost of borrowing money. Nearly 70 percent of the money spent on direct loans, however, is for loans made to so-called limited-resource borrowers at interest rates below that of the Treasury. Eliminating these below-cost loans would save the federal government $430 million in outlays over the 1995-1999 period.

In recent years, the amount of direct loans made by FmHA has fallen while the volume of commercial loans guaranteed by FmHA and used for the same purposes has increased. FmHA's guaranteed loans typically cost the government significantly less than direct loans; as a result, they allow more farmers to receive assistance from the same amount of funds. Eliminating the highly subsidized direct loans would accelerate the downward trend of funding but still provide a core amount of low-interest direct loans (but at no less than the Treasury's low rates) for those farmers who are unable to secure guaranteed loans from commercial lenders.

Proponents of eliminating the loans to limited-resource borrowers argue that there are too many farmers already and that the government should not be encouraging new farmers at a time when excess farm production triggers spending on other agricultural benefits such as subsidies. Furthermore, the Congress and FmHA intended direct loans to be available to borrowers only temporarily--until these farmers could improve their operations and qualify for commercial credit. But evidence reported by the General Accounting Office suggests that the "graduation rate" of current borrowers from direct to guaranteed loans is low, in part because incentives are lacking to encourage borrowers of FmHA money to shift from below-cost loans to guaranteed loans. One way to promote this move is to lessen the availability of direct loans.

Opponents of this option object to cutting limited-resource loans so soon after the enactment of the Agricultural Credit Improvement Act of 1992. The act requires FmHA to target a portion of direct and guaranteed loans toward beginning farmers and to sign long-term agreements with them. (Beginning farmers now have access to FmHA credit for no more than 15 years.) Many analysts believe that such assistance is necessary because people who are just entering farming may find it especially difficult to obtain or afford sufficient credit at commercial rates. Some observers are particularly concerned about the advancing average age of farmers and argue that assistance to younger farmers is needed. Moreover, only those farmers who have received loans in the past and who have not graduated to commercial credit (and for whom the 15-year limitation does not apply) would have to pay more for credit under the remaining available options.

DOM-16 END SMALL BUSINESS ADMINISTRATION LOANS AND LOAN GUARANTEES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			End All Credit Programs			
Budget Authority	550	570	580	600	620	2,920
Outlays	360	540	570	600	610	2,680
			Keep Minority and Disaster Programs			
Budget Authority	300	310	320	330	340	1,600
Outlays	200	290	320	330	340	1,480

The Small Business Administration (SBA) provides both direct loans and loan guarantees to qualified small businesses. The SBA's lending objectives are to promote business development generally, aid economically disadvantaged groups, and assist small businesses and homeowners in recovering from disasters. SBA outlays could be reduced by $2.7 billion over the 1995-1999 period by eliminating all SBA loan and loan guarantee programs. An alternative to eliminating all loans would be to retain only those that provide assistance to minorities and disaster victims. Continuation of those programs could be justified as aid to the socially or economically disadvantaged because of factors beyond their control. Following that course could reduce SBA outlays by $1.5 billion over the 1995-1999 period.

Under the loan guarantee program, the federal government guarantees 90 percent of the principal for business loans up to $155,000 and between 70 percent and 85 percent for larger ones. The interest rate on guaranteed loans is about 2.5 percentage points above the prime rate; in addition, the SBA guarantee has a charge equal to 2 percent of the amount guaranteed. In 1993, the SBA guaranteed 25,026 loans totaling more than $6 billion; the SBA share of the guaranteed loans was roughly $5 billion. Holders of about 380 guaranteed loans defaulted, and the loans were subsequently purchased by the SBA. The SBA share of the outstanding balances of those loans exceeded $57 million--an improvement over 1992, when the SBA share of such balances exceeded $650 million.

Under the direct loan program, the SBA provides loans to businesses located in high-unemployment or low-income areas and to businesses owned by minorities, handicapped individuals, and Vietnam veterans or disabled veterans. It also offers direct loans to homeowners recovering from natural disasters. Direct loans generally do not exceed $150,000, although some disaster loans run as high as $500,000. In 1993, the SBA approved 52,597 direct loans totaling $1.5 billion, bringing the total direct loan portfolio to more than $4 billion. In both the direct loan and loan guarantee programs, the SBA extends credit for up to 25 years--significantly longer than would otherwise be available to small businesses.

SBA assistance is favored by those who view it as a way of aiding small businesses, which, they argue, generally create more jobs, improve technology more rapidly, and satisfy some markets more efficiently than do large firms. When banks and other traditional sources of loans to small businesses tighten credit standards or become more conservative in their lending practices, SBA assistance can help fill a financing gap.

But others claim that SBA assistance tends to flow to the firms least likely to create stable em-

ployment, improve technology, or enhance national productivity. SBA loans and loan guarantees go primarily to businesses that have been rejected by conventional providers of financing. Perhaps as a result, they have a high default rate. It can also be argued that financial markets are now more efficient and less susceptible to the types of market failure that justified the SBA program when it first began.

DOM-17 SCALE BACK THE RURAL RENTAL HOUSING ASSISTANCE PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Stop Expansion			
Budget Authority	480	500	510	520	540	2,550
Outlays	40	260	330	380	420	1,430
			Increase Developers' Interest Rate to 5 Percent			
Budget Authority	180	190	190	200	200	960
Outlays	20	150	170	190	200	730

NOTE: The figures in the table exclude savings in administrative costs.

The Section 515 housing program, administered by the Farmers Home Administration (FmHA), provides low-interest, 50-year mortgage loans to developers of multifamily rental projects in rural areas. These mortgages typically have interest credits that reduce the effective interest rate to 1 percent and, in turn, lower rental costs for Section 515 tenants.

Under current rules, assisted tenants contribute toward their housing expenses the greater of 30 percent of adjusted income or the minimum project rent. The minimum project rent for each unit includes a proportionate share of the amortization costs of the 1 percent mortgage and of the project's operating expenses. The developer keeps the minimum rent, and the FmHA collects any payments above this minimum and treats them as additional interest payments to reduce the program's cost. Additional subsidies are provided through the Rural Rental Assistance Payments (RRAP) program to many of the poorest tenants to reduce their rent payments to 30 percent of their incomes. During 1993, the Section 515 program made $574 million worth of new loans to finance about 15,350 new rental units.

Stopping all new commitments for assistance under the Section 515 program would reduce federal outlays by about $1.43 billion over the 1995-1999 period, including $160 million for RRAP payments that would otherwise have been made. (See DOM-46 for a similar option for housing programs administered by the Department of Housing and Urban Development.) Additional savings would be realized eventually as the cost of administering a shrinking loan portfolio decreased.

An argument in favor of this option is that expanding rural rental assistance is inappropriate at a time when many other federal programs are being cut. Also, turnover among current residents of existing projects would ensure that some new income-eligible families would be assisted each year. However, this option would reduce the proportion of rural families being assisted as the number of eligible families continued to grow. Moreover, growth in the supply of standard-quality, low-income rental projects in rural areas would slow down.

Savings in outlays could also be realized by increasing tenant rental payments. This result could be achieved by raising the interest rate on loans to project developers, who would pass along the increased interest costs in the form of higher minimum project rents. Raising interest rates to 5 percent would save $730 million over the 1995-1999 period. Alternatively, tenants could be required to pay at least 35 percent of their incomes instead of the current 30 percent. This policy change would apply to tenants in all projects in the inventory, as opposed to the policy of raising interest rates on

developers' loans, which would affect only tenants in newly built projects. Requiring tenants to pay 35 percent of their incomes might be of particular interest if a similar increase were enacted for subsidized urban renters (see DOM-45). Data are not available, however, to estimate the savings from this alternative.

Although raising tenants' rents would increase above 30 percent the share of their incomes spent on housing, they would still be better off than the typical unassisted but equally poor renter, who pays nearly 50 percent. Arguing against raising the interest rates (and thus the minimum project rent) is the fact that this approach would affect primarily those poorer tenants who do not receive RRAP subsidies and who must pay the minimum project rent because it exceeds 30 percent of their income.

In contrast, raising the minimum contribution toward rent to 35 percent would affect households in the higher-income brackets and those receiving RRAP subsidies. A disadvantage of the 35 percent approach is that it might prompt some stable, higher-income households to move out of assisted housing projects, changing the economic mix of the projects and possibly reducing their viability.

DOM-18 SCALE BACK THE HOUSING LOAN PROGRAM FOR RURAL HOMEOWNERS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Eliminate New Direct Loans			
Budget Authority	360	370	380	390	400	1,900
Outlays	300	370	380	390	400	1,840
			Reduce New Direct Loans by 50 Percent			
Budget Authority	180	190	190	200	200	960
Outlays	150	180	190	190	200	910
			Increase Borrowers' Payments to 30 Percent of Income			
Budget Authority	250	260	270	280	280	1,340
Outlays	1,670	260	270	270	280	2,750

NOTE: The figures in the table exclude savings in administrative costs.

The Section 502 housing program, administered by the Farmers Home Administration (FmHA), provides mortgages to rural, low-income borrowers, many of whom live in areas with shortages of private mortgage credit. The FmHA's costs for this program include the costs associated with any future defaults on the loans and with the subsidies arising from the difference between the interest rates it pays to finance the program and the rates borrowers pay to obtain the FmHA mortgages. The latter rates can be as low as 1 percent. During 1993, in the continental United States, over 22,000 rural households with incomes averaging about $17,000 purchased single-family homes with loans at reduced interest rates from the FmHA. The total value of all new Section 502 direct loans in 1993 was nearly $1.3 billion.

Through this program, eligible borrowers can purchase homes by spending a portion of their income--generally 20 percent--on principal, interest, property taxes, and insurance (PITI) throughout the full mortgage term, usually 33 years. Eligible borrowers with relatively low incomes, however, have to pay somewhat more than 20 percent to amortize the loan at 1 percent. Incomes are recertified annually, and payments are adjusted as necessary. In contrast, almost two-fifths of all low-income homeowners in both metropolitan and nonmetropolitan areas spent more than 30 percent of income on housing in 1989.

The costs of this program could be cut by eliminating or reducing new lending or by increasing borrowers' payments. These options would reduce the present value of the mortgage interest subsidies and the cost of future defaults, which under credit reform are scored as outlays when the loans are originated.

Eliminate or Reduce New Direct Loans by 50 Percent. If new direct loans under the Section 502 program were eliminated, federal outlays would be reduced by $300 million in 1995 and about $1.8 billion over the 1995-1999 period. Alternatively, if new lending were reduced by half, federal outlays would fall by $910 million over the same five-year period. Additional savings would be realized over time as the cost of administering a shrinking portfolio decreased.

The current program may not be the best use of scarce federal resources. It makes rather sizable payments to relatively few households that, although having low incomes, are better off than many that receive no housing assistance of any kind. Yet if either option were enacted, rural, low-income households would probably experience greater difficulty becoming homeowners, both because the cost of home ownership would rise and because shortages of private mortgage credit exist in some areas where the program operates.

Increase Borrowers' Payments to 30 Percent of Income. If these rural housing loans were continued at the current volume and borrowers' payments were increased to 30 percent of income, federal outlays would be reduced by an estimated $1.67 billion in 1995 and about $2.75 billion in the 1995-1999 period. This option assumes that the increase in payments would be effective immediately for new borrowers and would be phased in over 10 years--at 1 percentage point per year--for current borrowers. The relatively large amount of savings in 1995 reflects budgetary practices under credit reform, which would score the present value of all savings associated with currently outstanding loans in the year the option becomes effective.

Increasing the percentage of income that borrowers pay for FmHA loans would eliminate disparities between the FmHA Section 502 program and home ownership programs sponsored by the Department of Housing and Urban Development. For example, under the Homeownership and Opportunity for People Everywhere program, home buyers pay 30 percent of their income for PITI and up to 35 percent for total housing costs, including utilities. This option would also reduce unequal treatment of assisted homeowners and renters, who generally pay 30 percent of their adjusted income for housing (and who would pay 35 percent under options described in DOM-17 and DOM-45).

Increasing the percentage of income that rural households pay toward home ownership, however, would result in a shift in the composition of borrowers away from households with the lowest incomes. In addition, higher costs relative to income might raise default rates among borrowers; historically, the foreclosure rate has been around 2.5 percent.

DOM-19 REDUCE THE BUDGET OF THE EXPORT ADMINISTRATION

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	10	10	10	10	10	50
Outlays	5	10	10	10	10	45

The Export Administration (EA) of the Department of Commerce enforces U.S. export laws to promote national security and foreign policy objectives. Its activities include ensuring availability of industrial resources for U.S. defense, licensing exports, and detecting and preventing foreign distribution of U.S. goods and technical data that are controlled for reasons of national security or foreign policy. Reducing the budget of the Export Administration by 25 percent would save $5 million in outlays in 1995 and $45 million over five years.

The enforcement activities of the EA reduce U.S. exports and thereby create economic inefficiencies that reduce U.S. gross national product. To the extent that they keep defense-related goods and technology out of the hands of potential adversaries, however, they promote U.S. security and foreign policy. The EA's activities to ensure availability of industrial resources (such as restricting foreign ownership of U.S. firms that are deemed to be defense-related) also have their economic efficiency costs and corresponding national security and foreign policy benefits.

The EA may be able to absorb cuts in its budget because of the demise of the former Soviet bloc and the elimination of sanctions against South Africa. Along these lines, the member countries of the Coordinating Committee on Multilateral Export Controls (COCOM) have agreed in principle to abolish COCOM by March 31, 1994, and to replace it with a new regime that would include Russia. Although the Western allies would still withhold some products from Russia, there would be fewer restrictions than there have been to date. Proponents of maintaining the EA's budget might argue, however, that a need for continued or even increased monitoring and enforcement has been underscored by recent concerns about North Korea's progress in developing nuclear weapons and by the post-Persian Gulf War disclosures of Iraq's progress in developing and obtaining the technology and materials for nuclear, chemical, and biological weapons. That COCOM is to be replaced by a new regime rather than simply abolished is a recognition of the continuing need for at least some monitoring.

DOM-20 ELIMINATE THE U.S. TRAVEL AND TOURISM ADMINISTRATION AND THE TRADE PROMOTION ACTIVITIES OF THE INTERNATIONAL TRADE ADMINISTRATION, OR CHARGE THE BENEFICIARIES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	220	230	240	250	250	1,190
Outlays	120	150	180	180	190	820

The U.S. Travel and Tourism Administration (USTTA) of the Department of Commerce promotes the United States as a tourist destination for foreign travelers. The International Trade Administration (ITA), also a part of the Commerce Department, has four direct program activities: the Import Administration, which investigates antidumping and countervailing-duty cases; the trade development program, which assesses the competitiveness of various U.S. industries and runs various export promotion programs; the international economic policy program, which develops policy, provides marketing services, and identifies and develops remedies for long-range trade and investment problems; and the U.S. and foreign commercial services, which counsel U.S. businesses on exporting. The latter three activities also help fight foreign barriers to U.S. exports. That effort, and perhaps the efforts against dumping and foreign subsidies, may be necessary to maintain public support for free-trade policies, and some of their elements can be defended on economic grounds. The ITA's export promotion, marketing, and counseling could be eliminated, however, or the beneficiaries could be charged fees to pay more of the costs. The same holds true for the USTTA's activities.

Eliminating or charging firms for the cost of these activities would reduce outlays or increase receipts by $120 million in 1995 and by $820 million over five years.

One might argue that such activities are best left to the firms and industries involved rather than to the ITA and USTTA. Alternatively, one might argue that there may be some economies of scale to these activities, especially for small firms and less popular tourist destinations. If so, having one entity (the federal government) counsel exporters on foreign legal and other requirements, disseminate knowledge of foreign markets, and promote U.S. products and tourist destinations abroad could make sense. In that case, net federal spending could be reduced by charging the beneficiaries their full cost.

To the extent that the beneficiaries are not charged the full cost, the ITA's and USTTA's activities effectively subsidize the industries involved. These implicit subsidies are an inefficient means of helping the industries because they are partially dissipated to foreigners in the form of lower prices for U.S. exports and for lodging and other tourist expenses. Because the current-account balance is determined by total saving and investment in the U.S. economy, over which the ITA and USTTA have no influence, the ITA's and USTTA's activities do not improve the current-account balance. As a result of changes they cause in exchange rates and other variables, all increases in exports and tourist expenditures resulting from the ITA's and USTTA's activities are completely offset by some mix of reduced exports of other industries and increased imports. Thus, other U.S. firms are hurt by the export and tourism promotion activities of these agencies.

DOM-21 ELIMINATE THE ADVANCED TECHNOLOGY PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Eliminate Program			
Budget Authority	200	210	220	220	230	1,080
Outlays	70	130	200	210	220	830
			Reduce Program to 1993 Levels			
Budget Authority	130	140	140	140	150	700
Outlays	40	90	130	140	140	540

Eliminating the Advanced Technology Program (ATP) of the Department of Commerce would save $830 million in outlays over the next five years (1995 through 1999) relative to the CBO baseline, and $1.8 billion in outlays over the same period relative to the Administration's budget request. An alternative to eliminating the program is to return its funding to 1993 levels; that option would save $540 million in outlays over the 1995-1999 period relative to the CBO baseline, and $1.5 billion in outlays over the same period relative to the Administration's budget request.

The objective of the ATP is to further the competitiveness of U.S. industry by helping convert discoveries in basic research more quickly into technological advancements with commercial potential. The Omnibus Trade and Competitiveness Act of 1988 established the ATP within the Commerce Department's National Institute of Standards and Technology. The program awards research and development (R&D) grants on the basis of merit to individual companies, independent research institutes, and joint ventures. The grants support research in generic technologies that have applications to a broad range of products, as well as precompetitive research (preceding product development).

The ATP's grants are limited to $2 million when awarded to a single firm, but they have no limit when awarded to a joint venture. Participating firms and research organizations pay more than half of the R&D costs of each project, which acts as a check on a project's commercial viability. The program received its first appropriation of $10 million in 1990; by 1994, its appropriations had grown to $200 million. As of the end of 1992, the ATP had funded 60 projects at a total cost of $180 million. An additional $61 million was awarded to 29 projects in November 1993. It is too early to determine the commercial success of projects funded by the ATP because even after a project has ended, more research is required for product development and commercialization. According to a recent study by the General Accounting Office, only four projects have ended (the ATP no longer funds them), and each was deemed successful in that the technology examined was found to be feasible. However, two of those projects are experiencing some difficulties with commercialization.

Opponents of the program argue that the near tripling of its funding between 1993 and 1994 (from $68 million to $200 million) may substantially lower the average quality of winning R&D projects. Moreover, the Administration has proposed further dramatic increases over the next five years. If the applicant pool does not increase as dramatically as the program's funding, the award process is likely to be less competitive. An alternative that is sometimes mentioned is to return the funding of the program to its lower 1993 level until the commercial success of some completed projects can be evaluated.

If the applicant pool does increase dramatically, the level of evaluation that occurs before an award is made may diminish. The National Institute of Standards and Technology, which runs ATP, would face an increase in its evaluation responsibilities with any expansion in the program. That increase would be in addition to the institute's new responsibility for assisting the Advanced Research Projects Agency within the Department of Defense to oversee defense conversion projects (under the Technology Reinvestment Project).

Opponents of the ATP further question whether the federal government is capable of picking projects with the most potential for technological and commercial success. Furthermore, those projects that stand out as clear "winners" might have been funded by the private sector in any case. One privately funded study of the 11 projects supported by the first competition in 1990 suggests that as many as half of those projects would probably have been undertaken even without ATP support, albeit at a lower level of funding.

Proponents of the program maintain that firms do not invest enough in research on generic technologies because they cannot fully appropriate the benefits for themselves. (For example, generic technologies are likely to have applications to products developed later by firms that did not invest in the original research.) Because the incentive for firms to invest in this type of research is weak, say these advocates, producing less investment than is socially optimal, government support is desirable. In addition, the program's supporters cite evidence that suggests that the ATP encourages the formation of joint ventures, increasing cooperation among firms and between firms and academic institutions.

DOM-22 REDUCE FEDERAL AID FOR MASS TRANSIT

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	2,200	2,200	2,400	2,450	2,550	11,800
Outlays	520	960	1,450	1,800	2,150	6,880

In 1994, the principal federal transit assistance programs will provide about $3.6 billion in capital grants and about $0.9 billion in operating assistance to local mass transit agencies. Federal grants generally pay 80 percent of the costs of qualifying capital projects and offset up to 50 percent of local transit system operating deficits. In 1990, federal capital grants accounted for about 60 percent of all public capital spending for mass transit, and federal operating subsidies offset roughly 5 percent of the operating costs of transit systems nationwide (and about 9 percent of the systems' operating deficits). Reducing the federal share of qualifying investment costs for mass transit to 50 percent (and reducing funding by a corresponding amount), and eliminating operating assistance, would save $520 million in outlays in 1995 and $6.9 billion over the 1995-1999 period.

The large federal shares of investment spending and the subsidies for operating assistance appear to have had little effect on either transit productivity or the use of mass transit services. Despite modernization of transit systems, only 6.5 percent of journeys to or from work are made by mass transit. Transit agencies serve mainly downtown areas, whereas most of the growth in urban travel has been in the suburbs. At the same time, inflation-adjusted labor costs per mile of transit travel rose by 60 percent during the 1970s, when overall assistance levels were highest. Reducing the federal share of capital costs for mass transit might improve local investment choices, as a similar reduction seems to have done in the case of federal subsidies for construction of local wastewater treatment plants. Similarly, ending operating assistance could encourage local authorities to make better use of existing capital by improving services, by using more cost-effective smaller vehicles, or by taking other steps to lower the operating costs of transit services.

Reducing federal transit subsidies, however, could harm some local transit services. The burden of diminished services would be borne disproportionately by people who are especially dependent on public transportation: the poor, the young, the elderly, and the disabled. Moreover, any reduction in transit service would occur just as the Clean Air Act of 1990 and the Intermodal Surface Transportation Efficiency Act of 1991 are placing increased pressure on states and localities to reduce their reliance on automotive transportation. Finally, an across-the-board cut in transit subsidies would be less efficient than targeted reductions, since certain transit investments, such as the rehabilitation of rail transit in older cities, could have a high payoff.

DOM-23 ELIMINATE AIRPORT GRANTS-IN-AID

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority[a]	1,740	1,780	1,830	1,880	1,930	9,160
Outlays	310	1,050	1,450	1,650	1,800	6,260

a. Assumes that contract authority is provided in amounts equal to the obligation limits projected in the CBO baseline.

Each year, the Federal Aviation Administration (FAA) provides airports with grants for expanding capacity and improving terminals. The grants are allocated by formula. Up to 49.5 percent of them are reserved for primary, commercial service airports; another 12 percent go to the states for distribution to general aviation airports; and the remainder are allocated among all airports on a discretionary basis. Eliminating these grants would result in savings of $310 million in 1995 and about $6.3 billion over the 1995-1999 period.

Recent trends in aviation have increased the importance of larger airports (as measured by the number of embarking passengers). These airports would have little trouble financing capital improvements from the fees collected or additional bonds issued if airport grants were eliminated. In 1991, the Congress passed legislation allowing airports to levy passenger facility charges (up to $3 per passenger). Those charges will supplement the revenues received from concessionaire rents, landing fees, and airline lease payments. In addition, revenues from the passenger facility charges, unlike federal grants, can be used to pay the interest on bonds issued by the airport. Passenger facility charges alone could bring in total annual revenues of about $1 billion to the 30 busiest airports. This revenue could be leveraged to support over $12 billion in borrowing.

Small "reliever" airports, financed by the FAA with the expectation that they would draw general aviation aircraft away from major airports, have not done so. Thus, some would argue against federal subsidies to these airports.

Supporters of the current program argue that the benefits provided by the system of airports are nationwide in scope. They also argue that more assistance is needed to overcome airport congestion and to allow airports to construct new gates and terminals that will promote competition among airlines, with benefits accruing to passengers.

DOM-24 ELIMINATE REGULATION OF MOTOR CARRIERS AND ABOLISH THE INTERSTATE COMMERCE COMMISSION

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	20	30	30	30	30	140
Outlays	20	30	30	30	30	140

The Interstate Commerce Commission (ICC) regulates rates, operating rights, and mergers and acquisitions of interstate motor carriers and railroads. It also rules on rail abandonments and construction of new rail lines. The ICC's powers have diminished since the passage in 1980 of the Motor Carrier Act and the Staggers Rail Act, and its staff and budget have decreased accordingly. But the vestiges of regulation remain, including a large number of routine applications for ICC approval of operating rights, rates, and other business decisions.

Taking the final step of the motor carrier deregulation process begun a decade ago--eliminating all remaining ICC regulation of trucking and intercity bus companies--could save the federal government about $20 million to $30 million annually. Deregulation would apply only to economic regulation; motor carrier safety would continue to be regulated by the Federal Highway Administration.

Current regulations impose costs not only on the federal government but also--and in much greater magnitude--on carriers and shippers. In 1990, motor carriers filed 20,000 applications for operating authority, nearly 1,000 applications for approval to merge with or acquire other motor carriers, and more than 1 million tariffs; railroads filed 185,000 tariffs. Estimates of deregulation savings to the private sector run as high as $28 billion a year.

Proponents of deregulation note that the trucking industry is highly competitive and that competition can reduce costs and increase productivity far more efficiently than can regulation. Opponents contend that the remaining regulation is not burdensome and that the open filing of tariffs and applications for operating rights, rate changes, and mergers protects carriers and shippers.

As with motor carriers, eliminating requirements for railroads to file applications for routine matters could reduce costs to the federal government as well as to the industry. There is considerable debate, however, over whether the rail industry is sufficiently competitive to protect the interests of shippers. For instance, some shippers have access to only one rail line, and some communities depend on rail service for their economic vitality. Authority to handle cases involving market power could be shifted to the Department of Transportation if the ICC were abolished. Advocates of more extensive deregulation of railroads argue that the ability of shippers to enter into long-term contracts with railroads diminishes the railroads' market power. They also note that communities dependent on rail can provide subsidies or other incentives to keep rail operations in business.

DOM-25 ELIMINATE FUNDING FOR HIGHWAY DEMONSTRATION PROJECTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	1,350	1,300	1,300	1,350	1,400	6,700
Outlays	80	330	560	740	880	2,590

Under CBO baseline assumptions, the federal government will provide a total of $105.7 billion in highway grants to states during the 1995-1999 period. The states will obligate most of this money on highway projects of their own choosing. The Department of Transportation will distribute about $99.0 billion, or 93 percent of the total, according to broad statutory formulas and other procedures prescribed by law. The remaining $6.7 billion will be obligated on projects earmarked by the Congress in the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA). (ISTEA contains more than 500 separate projects.) If the Congress amended ISTEA to eliminate contract authority for the demonstration projects contained in the bill, it would lower the amount of budget authority by $6.7 billion and the amount of outlays by $2.6 billion over the 1995-1999 period.

Critics argue that, in many instances, demonstration projects cannot be justified by economic criteria. For example, a survey of demonstration projects authorized in the 1987 surface transportation bill found that about half of these projects did not appear in state transportation plans. More than 10 percent of the projects would not have qualified for funding under the regular highway grant programs. Funding for demonstration projects therefore encourages construction that neither state transportation officials nor the broader federal highway program regard as being of primary importance.

Those who favor demonstration projects argue that the projects reflect important needs that are not addressed sufficiently by the regular process of highway funding. For example, demonstration projects can provide economic aid for particular geographic regions or fund construction that involves costs or risks that are too great for individual states. Thus, ISTEA provides funding for projects that are intended, among other things, to accelerate the construction of high-cost bridges, demonstrate innovative techniques for highway construction and finance, and improve methods to relieve congestion. Formal studies of the benefits expected from individual projects, however, are rarely available, making it difficult to assess whether demonstration projects achieve their intended purposes.

DOM-26 ELIMINATE THE OPERATING SUBSIDY FOR AMTRAK

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	360	370	380	390	400	1,900
Outlays	360	370	380	390	400	1,900

The federal government provides the National Railroad Passenger Corporation (Amtrak) with subsidies of about $360 million a year for operating expenses, in addition to $200 million in capital grants and $225 million for the Northeast Corridor Improvement Program. Eliminating the operating subsidy could save $360 million in outlays in 1995 and $1.9 billion from 1995 through 1999.

When the Congress established Amtrak in 1970, it expected to provide subsidies only for a limited time, until Amtrak could become self-supporting. Instead of declining, however, federal subsidies rose steadily in the 1970s, to nearly $1 billion in 1981. The Administration then proposed substantial cuts in federal funding. Amtrak subsequently raised fares and reduced costs, and subsidies have declined. Eliminating the operating subsidy would force Amtrak to intensify its efforts to cut costs and expand revenues.

Proponents of cutting subsidies argue that passenger rail service should compete on a level playing field with other modes of transportation--without the advantage of federal subsidies. Rail service in that case would have to become more efficient. Proponents also question the fairness of subsidizing the travel of business people, who make up a substantial share of Amtrak's passengers.

Opponents of cutting subsidies say that reducing federal support would lead Amtrak to cancel service on lightly traveled routes and that passengers in those areas might not have alternative transportation available. They also note that subsidizing rail service in congested areas may be justified as a way of offsetting the costs of congestion in travel by highway or air. Retaining federal subsidies for the Northeast Corridor Improvement Program may help to redress that imbalance.

DOM-27 ELIMINATE CERTAIN RURAL DEVELOPMENT PROGRAMS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Eliminate Direct Loans and Loan Guarantees			
Budget Authority	200	210	220	220	230	1,080
Outlays	10	60	120	160	200	550
			Eliminate Grants			
Budget Authority	570	590	610	620	640	3,030
Outlays	20	120	280	430	530	1,380

NOTES: Programs include direct loans for rural development; direct loans and loan guarantees for water and waste disposal and for community facilities; loan guarantees for business and industry; and grants for water and waste disposal, rural development, fire protection, solid waste management, and emergency community water assistance.

The figures in the table exclude savings in administrative costs.

The Rural Development Administration (RDA) assists rural development through a variety of programs. In general, the programs provide loans, loan guarantees, and grants for rural water and waste disposal projects, community facilities, rural development, and fire protection. Funds are generally allocated among the states based on their rural populations and the number of their rural families with incomes below the poverty threshold. Within each state, funds are awarded competitively to eligible applicants, including state and local agencies, nonprofit entities, and (in the case of loan guarantees for business and industry) for-profit organizations.

The amount of interest that loan applicants pay varies with the type of aid they receive and, in some programs, the economic condition of the area. For example, for rural water and waste disposal loans, interest rates average 5.6 percent but can range from 5 percent to market rates, depending on the median family income of the service area. If repayment of a loan would impose an undue financial burden on the residents of relatively poor areas, these areas may receive grants instead.

For 1994, the Congress appropriated a total of almost $200 million in budget authority to support the costs of $1.4 billion in combined direct loans and loan guarantees. Under credit reform, those costs include the present value of interest subsidies and the cost of loans that go into default. In addition, a total of $560 million was appropriated for grants, of which $500 million is for water and waste disposal. Eliminating the loan programs would reduce federal outlays for subsidizing direct loans and loan guarantees by a total of $550 million over the 1995-1999 period. Additional savings would be realized gradually as the costs of administering a shrinking portfolio decreased. Eliminating grants would save about $1.4 billion in outlays over the same period.

One argument for terminating these programs is that federal funds should be targeted toward activities whose benefits are national in scope, with state and local governments funding rural development. Moreover, research by the Center for Community Change found that two of the largest programs--the water and waste disposal program, and the business

and industry program--are not well targeted toward low-income or distressed communities. Higher-income rural communities, the study found, were more likely to receive assistance--including higher subsidies--than were low-income ones.

Supporters of federal funding of rural development programs argue that, by sparking economic growth, the programs help to increase rural incomes. Eliminating these funding sources would probably reduce economic development activities because private credit may simply not be available in some areas and many fiscally distressed states and localities would be unable to offset the loss of federal grants and interest subsidies.

DOM-28 ELIMINATE THE ECONOMIC DEVELOPMENT ADMINISTRATION

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	360	370	380	390	400	1,900
Outlays	40	150	260	330	360	1,140

The Economic Development Administration (EDA) provides grants to state and local governments for public works, technical assistance, defense conversion activities, and job programs, as well as loan guarantees to firms for business development. For 1994, appropriations for EDA programs total $350 million. No funds were appropriated for new loan guarantees for 1994. Disbanding the EDA would reduce federal outlays by about $40 million in 1995 and $1.1 billion over the 1995-1999 period.

One criticism of EDA programs is that federal assistance should not be provided for activities whose benefits are primarily local and which therefore should be the responsibility of state and local governments. In addition, EDA programs have been criticized for substituting federal credit for private credit and for facilitating the relocation of businesses from one distressed area to another through competition among communities for federal funds. The EDA has also been criticized for its broad eligibility criteria, which allow areas containing 80 percent of the U.S. population to compete for benefits, and for providing aid with little proven effect compared with other programs having similar goals. Furthermore, because of the competitive nature of EDA programs, local governments do not incorporate this type of aid into their budget plans; hence, eliminating future EDA funding would not impose unexpected hardships on communities.

Some of the reduction in aid associated with this option would, however, curtail economic development activities in financially distressed communities that have no other available resources. This cutback could result in the deterioration of infrastructure, the loss of prospective jobs, and decreases in local tax receipts in these areas, which are likely to be among the last to recover from the recent recession.

DOM-29 ELIMINATE THE APPALACHIAN REGIONAL COMMISSION

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	260	260	270	280	280	1,350
Outlays	10	80	160	200	240	690

The federal government provides annual funding to the Appalachian Regional Commission (ARC) for activities that promote economic growth in the Appalachian counties of 13 states. For 1994, the Congress appropriated $250 million for the ARC. The states are responsible for filing development plans and for recommending specific projects for federal funding. The commission distributes the funds competitively, based on such factors as the area's growth potential, per capita income, and rate of unemployment; the financial resources of the state and locality; the prospective long-term effectiveness of the project; and the degree of private-sector involvement.

The ARC supports a variety of programs, including the Appalachian Development Highway System, to open up areas with development potential; the Community Development Program, primarily to create jobs; the Human Development Program, to improve rural education and health; and the Research and Local Development District Programs, to provide planning and technical assistance to multicounty organizations. Federal funds also support 50 percent of the salaries and expenses of the ARC staff. Discontinuing the programs funded through the ARC would reduce federal outlays by $10 million in 1995 and by $690 million over the 1995-1999 period.

Those in favor of termination argue that the programs supported by the ARC duplicate activities funded by other federal agencies, such as the Department of Transportation's federal highways program and the Department of Housing and Urban Development's Community Development Block Grant program. Critics of the ARC also contend that, although it allocates resources to poor rural communities, those areas are no worse off than many others outside the Appalachian region and therefore no more deserving of special federal attention.

Nevertheless, eliminating federal funding of the ARC programs would reduce economic development activities in the region, because the fiscal distress of many states and localities would probably preclude their offsetting this loss of resources. Thus, fewer jobs might be created, and rural infrastructure, education, and health care conditions might deteriorate in a region that is likely to be among the last to recover from the recent recession.

DOM-30 ELIMINATE OR RESTRICT COMMUNITY DEVELOPMENT BLOCK GRANTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Eliminate CDBG Program						
Budget Authority	4,500	4,650	4,750	4,900	5,050	23,850
Outlays	150	2,050	3,950	4,700	4,800	15,650
Restrict Eligibility and Reduce Funding						
Budget Authority	620	630	650	670	690	3,260
Outlays	20	280	540	640	660	2,140

The Community Development Block Grant (CDBG) program provides annual grants, by formula, to eligible metropolitan cities and urban counties through what is referred to as its entitlement component. Under the formula, jurisdictions with greater needs (as measured by factors such as population, poverty levels, and housing conditions) receive larger grants than those with lesser needs. The program also allocates funds, by formula, to each state. The latter funds are distributed among nonentitlement areas, typically through a competitive process. Nonentitlement areas generally are units of local government that have populations under 50,000 and that are not metropolitan cities or parts of urban counties.

Community Development Block Grants in general must be used to aid low- and moderate-income households, to eliminate slums and blight, or to meet emergency needs. In accomplishing these goals, they may be used for a wide range of community development activities, including rehabilitation of housing, improvement of infrastructure, and economic development. Funds from the entitlement component may also be used to repay principal and interest on obligations that are issued by local governments to finance certain activities--such as the acquisition or rehabilitation of public property--and that are guaranteed by the federal government under the Section 108 loan guarantee program.

For 1994, the appropriation for the CDBG program amounts to $4.4 billion. Of this total, $3.0 billion is allocated to metropolitan cities and urban counties, and $1.3 billion goes to nonentitlement government units, with the remainder earmarked for specific purposes described in the appropriation act. Substantial federal savings could be realized either by terminating the CDBG program or by restricting eligibility for the entitlement component to exclude the least needy jurisdictions while reducing funding levels. Least needy jurisdictions could be defined by measuring relative economic well-being and fiscal capacity using factors such as the number and percentage of families below the poverty level and per capita income.

Eliminate the CDBG Program. If the CDBG program were eliminated, savings in federal outlays would amount to around $150 million in 1995 and a total of $15.65 billion over the 1995-1999 period. One argument for terminating the program is that federal funds should be targeted toward programs whose benefits are national rather than local. Accordingly, programs such as the CDBG program, which generate primarily local benefits, should be funded by state and local governments. Moreover, to the extent that local jurisdictions use CDBG funds to help them compete against each other to attract business, benefits are shifted away from local jurisdictions to private firms.

Without the CDBG program, however, a number of its activities would not be undertaken by most local governments--particularly the rehabilitation of low-income housing and, to some extent, economic development. Since the CDBG program is the largest source of federal aid for many cities, fewer resources would be available for low-income households. Furthermore, CDBG funding has presumably been figured into the budgets of entitlement recipients. Ending that support could impose at least temporary stress on many governments, some of which continue to experience fiscal difficulties.

Restrict Eligibility and Reduce Funding. If the entitlement component of the program were cut by, for example, 20 percent, federal outlays could be reduced by $20 million in 1995 and $2.14 billion over the 1995-1999 period. One way of achieving such a cut would be to eliminate funding for a sufficient number of the least needy jurisdictions. A cutback of this kind would effectively increase the proportion of funds going to the nonentitlement component from 30 percent to 35 percent, but the typically competitive nature of the distribution process would presumably ensure that those funds would be targeted toward the neediest areas. Carrying out this option would require both a change in the authorizing legislation and a cut in the program's annual appropriation.

An argument in favor of such a cutback is that no pressing interest is served by supporting jurisdictions that have above-average ability to fund projects themselves. For example, 15 of the 20 counties that had the highest per capita income in the nation in 1989 received funds in 1993 under the CDBG entitlement component. Eliminating funding for these types of jurisdictions, rather than reducing grants across the board, would ensure that the most distressed jurisdictions retained the same level of aid. However, a reduction in federal funds for affluent jurisdictions would probably curtail activities designed to aid low- and moderate-income households in any pockets of poverty in those areas, because local governments would probably not completely offset the reduction.

DOM-31 REDUCE FEDERAL SUPPORT FOR TENNESSEE VALLEY AUTHORITY ACTIVITIES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	150	150	150	160	160	770
Outlays	40	120	140	150	160	610

The annual appropriation for the Tennessee Valley Authority (TVA) provides federal support for the TVA's stewardship of its lands, facilities, and natural resources, and for other activities. Stewardship includes maintaining a system of dams and reservoirs and managing TVA-held water and land. In addition, the TVA provides recreational programs, promotes public use of its land and water resources, and operates an environmental research center. In fiscal year 1994, the TVA received appropriations for these activities totaling $140 million and also received revenues from fees. Eliminating many of the activities supported by appropriations and increasing the funding from nonfederal sources could reduce federal outlays by about $40 million in fiscal year 1995 and $610 million for the 1995-1999 period.

Because many of TVA's stewardship activities are necessary to maintain its power system, their costs would more appropriately be borne by users of the power. For fiscal year 1994, the TVA will allocate about $90 million to stewardship activities, of which about $20 million will be derived from sales of power. Other stewardship activities not related to the power system could be discontinued, or their costs could be recovered from the beneficiaries. Direct costs to the federal government could be reduced by about $70 million annually if the TVA were to increase power rates or fees to cover costs of all stewardship activities, or if the activities were eliminated.

Some critics claim that other TVA activities, such as providing recreational facilities, are beyond the scope of the TVA and should not be federally supported. They could be underwritten by state or local governments, or by fee-for-service mechanisms. Critics also argue that most activities of the national fertilizer and environmental research center benefit the private sector and should be supported by private funds. By discontinuing its support of the center, the federal government could save about $35 million annually.

Supporters of continued federal funding argue that its removal would damage the TVA's ability to meet its federally mandated mission. That mission includes aiding the proper use, conservation, and development of the region's natural resources, as well as promoting its economic well-being.

DOM-32 ELIMINATE ANCILLARY VOCATIONAL EDUCATION PROGRAMS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
	Eliminate Community-Based Organizations Programs					
Budget Authority	10	10	15	15	15	65
Outlays	a	10	10	15	15	50
	Eliminate Consumer and Homemaking Education Program					
Budget Authority	35	35	40	40	40	190
Outlays	5	30	35	35	35	140

a. Less than $2.5 million.

Vocational education--occupationally specific instruction in such areas as business math, industrial arts, electronics, and office management--is widely offered in U.S. secondary schools. Federal legislation in the form of the Carl D. Perkins Vocational and Applied Technology Education Act is intended to help states ensure equal vocational education opportunities for traditionally underserved populations. The act also funds qualitative improvements in vocational education programs in order to increase work force productivity and promote economic growth. In addition to its core programs, this legislation established others that are ancillary to its larger purposes. Two of these are the Community-Based Organizations programs and the Consumer and Homemaking Education program. Eliminating them would probably not affect the accomplishment of the central purposes of the legislation and could save about $190 million over the 1995-1999 period.

Eliminate Community-Based Organizations Programs. These programs fund projects that include outreach efforts to locate likely recipients of vocational education; prevocational basic-skills training, guidance, and counseling; and career intern programs. In 1993, 53 grants were made to states and outlying areas for about $12 million; most states then used competitive grants to fund local recipients. Eliminating these programs could save about $50 million in outlays over the 1995-1999 period.

People who argue for eliminating these programs have several criticisms. The services the programs fund are ancillary to vocational education in that they do not address the allocation or quality of occupationally specific instruction. In some cases, the services only supplement those funded by other sources. States tend to distribute funds among a large number of organizations located in different parts of the state, and many awards appear to be too small to make a significant difference. Furthermore, most states do not conduct formal evaluations of the projects they fund.

Proponents of the programs argue that they complement the efforts of the core Vocational Education Basic Grant program. For example, they fund efforts to reach disadvantaged individuals who may not be served by regular vocational education programs; these people include school dropouts, substance abusers, teenage parents, and immigrants with limited language skills. The services offered through community-based organizations can also provide beneficiaries with the attitudes and basic skills they need to succeed in mainstream vocational education programs.

Eliminate the Consumer and Homemaking Education Program. This program provides grants to states to prepare youths and adults to be homemakers. Federal funds are allocated according to a

state's per capita income and population; one-third of each state's allotment must go to economically depressed areas. These funds can be used for instruction in family living and parenthood, food preparation and nutrition, child development and guidance, home management, and the like. In 1993, about $35 million was appropriated for this program, and 53 grants were made to the states, the District of Columbia, and outlying areas. Eliminating the program would reduce federal outlays by about $140 million over the 1995-1999 period.

Critics of the Consumer and Homemaking Education program argue that there is no essential federal role in educating people to be homemakers and that federal funds are not necessary to support these activities. Federal funds generally supplement state and local programs for elementary and secondary schools, where state and local dollars have exceeded federal dollars by more than 20 to 1. If they chose, states and localities could use funds from their Basic Grants to States to continue these services.

Proponents of the program see it as an important supplement to efforts to reduce sex bias and stereotyping in family life. The program also provides funds for ancillary services (including outreach) to ensure the quality and effectiveness of local programs. Without federal support, local consumer and homemaking education services might be restricted or reduced in quality.

DOM-33 ELIMINATE EDUCATION PROGRAMS THAT HAVE LARGELY ACHIEVED THEIR PURPOSE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Public Library Construction						
Budget Authority	20	20	20	20	20	100
Outlays	a	10	20	20	20	70
Follow Through						
Budget Authority	10	10	10	10	10	50
Outlays	a	5	10	10	10	35
Law-Related Education						
Budget Authority	5	5	5	5	10	30
Outlays	a	5	5	5	10	25
Law School Clinical Experience						
Budget Authority	15	15	15	15	20	80
Outlays	a	10	15	15	20	60
Total Savings						
Budget Authority	50	50	50	50	60	260
Outlays	5	30	50	50	55	190

a. Less than $2.5 million.

The Department of Education funds at least 230 programs that address a range of problems at all levels of education. Four of the programs continue to be funded even though they have largely or completely achieved their original purposes or could be supported by other funding sources. The annual cost of these four programs ranges from about $5 million to $20 million each. Eliminating all of them would save about $190 million over the 1995-1999 period.

Public Library Construction. This program is intended to fund facilities so that all people have access to local public library services. Eliminating it would reduce federal outlays by about $70 million over the 1995-1999 period.

The argument for elimination is that access to public libraries is now virtually universal, making continued federal funding for new library facilities unnecessary. Opponents of elimination argue that the program provides assistance that is still needed in building or modifying libraries, including alterations necessary to meet federal guidelines for access by the disabled.

Follow Through. This program's purpose is to develop educational practices that help low-income children in the early elementary grades fulfill their potential. Eliminating this program would reduce federal outlays by about $35 million over the 1995-1999 period.

Those who would eliminate Follow Through note that it was initiated in 1968 as a short-term experimental program. It generated many ideas, but now the Chapter 1 Basic Grant program is the appropriate vehicle for funding state and local educational agencies to develop as well as to implement services for disadvantaged children in preschool and elementary school grades. The counterargument is that Follow Through grants, now awarded competitively, are still being used to fund innovative projects to help disadvantaged children retain in the early elementary school grades the cognitive gains made in preschool programs.

Law-Related Education. This program aims to provide children, youth, and adults with knowledge and skills pertaining to the law and to the legal principles and values on which it is based. Eliminating the program would reduce federal outlays by about $25 million over the 1995-1999 period.

The argument critics make for eliminating this program, which was first funded in 1980 and supported 37 projects in 1993, is that it has successfully supported the institutionalization of law-related education, including teacher training. Past recipients of grants should be able to continue without federal assistance. Those who want to maintain the program argue that many of the funded projects support outreach efforts to disabled and minority youth. Without federal funding, these efforts could collapse.

Law School Clinical Experience Program. This program is intended to establish or expand law school programs to provide clinical experience in the practice of law, especially the preparation and trial of actual cases. Eliminating this program, which supported some 2,900 law students in more than 100 institutions in 1993, would reduce federal outlays by about $60 million over the 1995-1999 period.

Program critics argue that it should be eliminated because it was established to demonstrate the concept of clinical legal education, not to support it as a permanent federal responsibility. Most law schools now offer clinical education and would continue to do so in the absence of federal support. Program supporters argue that some law schools still make only a marginal commitment to clinical education in their budgets. If the program were eliminated, those law schools might drop their clinical education programs, depriving their students of this experience.

DOM-34 ELIMINATE STATE STUDENT INCENTIVE GRANTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	75	75	80	80	80	390
Outlays	35	75	80	80	80	350

The State Student Incentive Grant (SSIG) program helps states provide financially needy postsecondary students with grant and work-study assistance. States must match federal funds at least dollar for dollar, while also meeting maintenance-of-effort criteria. Unless excluded by state law, all public and private nonprofit postsecondary institutions in a state are eligible to participate in the SSIG program. In 1993, the federal government appropriated $73 million, which was matched by 50 states and seven outlying areas; the money was distributed to an estimated 240,000 students.

Eliminating SSIGs would save the Treasury about $350 million during the 1995-1999 period. If a portion of the resulting savings from eliminating this program were redirected to the Federal Pell Grant Program, which assists financially needy undergraduates, some of the adverse effects of eliminating SSIGs could be alleviated. In either case, the extent of the actual reduction in assistance would depend on the responses of states, some of which would probably make up part of the lost federal funds.

Proponents of eliminating this program argue that it is no longer needed to encourage states to provide more student aid. When the SSIG program was authorized in 1972, only 31 states had student grant programs; now, all 50 states provide student grants. Furthermore, state need-based aid for undergraduates increased from $1.1 billion (in 1993 dollars) in academic year 1973-1974 to an estimated $2.2 billion in academic year 1993-1994, when about 1.6 million students received such aid.

Opponents of eliminating SSIGs argue that not all states would increase their student aid appropriations to make up for the lost federal funding and some might even reduce them. Eight states just met the SSIG matching provision in academic year 1991-1992. In addition, many other states are now having financial problems and might not be able to make up the loss of SSIG funds.

DOM-35 ELIMINATE OR REDUCE FUNDING TO SCHOOL DISTRICTS FOR IMPACT AID

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Eliminate All Impact Aid			
Budget Authority	820	840	870	890	910	4,330
Outlays	660	810	860	880	910	4,120
			Eliminate All But Half of Aid for "a" Children			
Budget Authority	490	510	520	540	550	2,610
Outlays	400	490	510	530	550	2,480
			Eliminate Impact Aid for "b" Children			
Budget Authority	140	140	150	150	160	740
Outlays	110	140	150	150	160	710

School Assistance in Federally Affected Areas--also known as Impact Aid--is intended to compensate school districts that have children who are enrolled because their parents live or work on federally owned or subsidized property. Since property of that type is tax-exempt, Impact Aid compensates school districts for the forgone property tax revenues that would have supported the schools.

Impact Aid goes to school districts for two categories of children: "a" children, whose parents both live and work on federal property; and "b" children, whose parents either live or work on federal property. A minimum of 3 percent of the children enrolled in a school district (or at least 400 children) must be federally connected for a district to be eligible. In 1992, Impact Aid went to approximately 2,500 school districts spread across all states. Payments for "a" children--at an average of $1,613 per child in 1992--have been found to go disproportionately to school districts with high expenditures per pupil and to school districts with low average property values. Payments for "b" children --at an average of $71 per child in 1992--have been found to be relatively evenly distributed across school districts with high and low expenditures per pupil. School districts in 8 of the 10 richest counties in the United States are among the beneficiaries of the Impact Aid program.

Eliminating all funding for Impact Aid would reduce federal outlays by about $4.1 billion in the 1995-1999 period. Opponents of the program argue that the economic benefits from federal installations outweigh the demands placed on the schools, making the program unnecessary. These economic benefits are considered so substantial that local jurisdictions compete vigorously for new federal installations and lobby intensely to forestall closing existing ones.

Proponents of the program counter that the presence of federal installations does not adequately compensate local governments and school districts for losses in property tax revenues. Additional revenues resulting from federal installations are collected primarily by the state through income and sales taxes. Moreover, many school districts--especially isolated ones having military installations with large numbers of "a" children--would face severe financial hardship if such funding were eliminated.

A second option would eliminate all Impact Aid except for half of the "a" payments. The remaining Impact Aid funds would be targeted toward school districts enrolling large numbers of "a" children. This alternative, which would require changes in authorizing legislation, would reduce federal spending by about $2.5 billion over the 1995-1999 pe-

riod; it would also ensure that scarce federal funds went only to the school districts most affected by federal activities. School districts with only "b" children or relatively few "a" children, however, would have somewhat less funding unless state or local resources were increased.

A third option would eliminate Impact Aid only for "b" children, thereby reducing federal outlays by $710 million over the 1995-1999 period. This alternative would significantly limit any negative effects on school districts, compared with ending larger portions of Impact Aid. Proponents of this alternative note that school district operations do not generally depend on "b" payments, which constitute less than one-half of one percent of total expenditures in more than half of the districts receiving them. The parents of "b" children also pay state and local taxes, which fund educational expenditures, at almost the same rate as the parents of children who are not federally connected. Opponents of this option argue that "b" payments are important for a few school districts--for example, those in which large numbers of military families live in the community but shop at military exchanges, which do not collect state and local sales taxes.

DOM-36 ELIMINATE UNTARGETED FUNDING FOR MATHEMATICS AND SCIENCE EDUCATION

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	290	300	300	310	320	1,520
Outlays	40	230	290	300	310	1,170

Most federal aid for elementary and secondary education is targeted toward students with special needs. Federal funds for compensatory education under Chapter 1 of Title I of the Elementary and Secondary Education Act of 1965, for example, are intended for low-achieving students in schools with many poor children. Federal funds are also provided to help educate children with disabilities.

Substantial amounts of federal money, however, are provided with no federal requirement for targeting funds toward students with special needs or toward the teachers who serve them. An example is the portion of the mathematics and science education grants not targeted toward students with special needs. Ending funding for this portion would reduce budget authority by about $1.5 billion, and outlays by about $1.2 billion, over the 1995-1999 period.

On the one hand, this option would generate significant federal savings and affect total spending for elementary and secondary education only minimally because the reduction would constitute considerably less than 1 percent of total local, state, and federal expenditures on education. Moreover, districts might offset part or all of the reduction in federal funding for the activities of special concern to them.

On the other hand, this program has a purpose other than increasing services to students with special needs--namely, to support several of the National Education Goals announced by President Bush and the governors in 1990. The reductions could pose hardships for some jurisdictions that are trying to meet those goals. In particular, the progress of students in mathematics and science might be slower if federal funding were ended.

DOM-37 ELIMINATE 19 GRANT PROGRAMS IN THE DEPARTMENT OF EDUCATION

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	170	170	180	180	180	880
Outlays	30	130	170	180	180	690

The National Performance Review (NPR) has recommended that the Department of Education terminate a number of small grant programs, including the 19 programs that would be eliminated under this option. (Eight other education programs that the NPR suggested should be terminated are addressed under separate options in this volume; see DOM-32, DOM-33, DOM-34, and DOM-35. Still others recommended for elimination did not receive funding in 1994.) The Congress appropriated about $170 million in 1994 for the 19 programs considered here. Eliminating these programs would reduce federal spending by $690 million over the 1995-1999 period.

The 19 grant programs vary in size and serve a wide range of purposes. The largest is the Immigrant Education program, which received almost $40 million in 1994. The smallest is Assistance to Guam, which provided about $400,000 to post-secondary institutions in Guam in partial reimbursement of the costs of educating nonresident Micronesian students. Other programs include the Dropout Prevention Demonstration, several small programs for libraries, the Fund for the Improvement and Reform of Schools and Teaching, the Territorial Teacher Training program, Ellender Fellowships (a grant to the Close Up Foundation to bring economically disadvantaged persons to Washington, D.C., to increase their understanding of the federal government), Cooperative Education (grants for programs that alternate periods of academic study and employment), Bilingual Vocational Education, Education for Native Hawaiians, General Assistance to the Virgin Islands, and Foreign Language Assistance.

The NPR recommended terminating these programs because they duplicate other programs, they have achieved their purposes, or they are more appropriately supported with nonfederal funds. The Department of Education has already suggested eliminating 8 of the 19 programs in its legislative proposal for reauthorizing the Elementary and Secondary Education Act of 1965, as amended. The President's proposed budget for 1995 eliminates funding for all 19 programs.

Supporters of these myriad programs argue that many have been successful in addressing the specific problems for which they were created and that they are still needed because the underlying conditions continue to exist. Advocates also argue that alternative funding from local and state governments or private sources would probably not be forthcoming if the federal programs were eliminated.

DOM-38 ELIMINATE OR REDUCE FUNDING FOR THE ARTS AND HUMANITIES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Eliminate Funding						
Budget Authority	1,050	1,100	1,150	1,200	1,200	5,700
Outlays	770	1,030	1,100	1,200	1,200	5,300
Reduce Funding by 50 Percent						
Budget Authority	540	560	580	590	610	2,880
Outlays	390	520	560	590	610	2,670

NOTE: The savings shown in 1995 and 1996 would require a rescission of all or part of the advance appropriations for the Corporation for Public Broadcasting of $293 million in 1995 and $312 million in 1996.

The federal government subsidizes various arts and humanities activities. In 1993, federal outlays for the Corporation for Public Broadcasting, the Smithsonian Institution, the National Gallery of Art, the National Endowment for the Arts, and the National Endowment for the Humanities totaled $1.1 billion.

Eliminating funding for these programs would reduce federal outlays by about $5.3 billion in the 1995-1999 period, and cutting funding in half would save almost $2.7 billion during that period. The final effect of either option on arts and humanities activities would depend on the extent to which other funding sources--states, private individuals, firms, and foundations increased their contributions and on whether admission fees to these activities were used to make up for reduced federal funding.

Proponents of this option argue that federal funding for the arts and humanities is not affordable in a time of fiscal stringency, especially when programs addressing central federal concerns are not fully funded. Moreover, because many arts and humanities programs benefit predominantly higher-income people, instituting or raising admission fees could substitute for federal aid in many cases. In a number of cities here and abroad, for example, museums charge fees.

Reducing or eliminating federal appropriations for the arts and humanities would probably result in fewer of these activities, however, because other funding sources would not be likely to offset fully the loss in federal subsidies. As a result, activities that preserve and advance the nation's cultural heritage would be likely to decline.

DOM-39 ELIMINATE FEDERAL FUNDING FOR CAMPUS-BASED STUDENT AID

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Eliminate Campus-Based Aid						
Budget Authority	1,400	1,430	1,470	1,510	1,550	7,360
Outlays	140	1,360	1,440	1,470	1,510	5,920
Eliminate Campus-Based Aid and Redirect Half of the Savings to Pell Grants						
Budget Authority	700	720	740	750	770	3,680
Outlays	0	670	720	730	750	2,870

The federal government provides campus-based student aid through three programs: Supplemental Educational Opportunity Grants, Perkins Loans (formerly National Direct Student Loans), and Work-Study. Financial aid administrators at postsecondary institutions determine which eligible students receive aid under general federal guidelines. In 1994, the federal government provided $1.4 billion in campus-based aid, which will go to approximately 1.7 million students.

Eliminating federal funding of these programs would lower outlays by about $5.9 billion during the 1995-1999 period. Alternatively, half of the savings from eliminating these programs could be redirected to the Federal Pell Grant Program, which provides grants for undergraduate students on the basis of national standards of financial need. Accordingly, the Pell Grant program is more closely targeted toward low-income students. The extent of the reduction in total student aid would depend on the responses of postsecondary institutions, some of which would make up part or all of the lost federal funds. Moreover, since postsecondary institutions retain about $6.0 billion in revolving funds under the Perkins Loan program, an estimated 724,000 students would receive loans, averaging about $1,340 in 1994, even if the federal government did not fund any new campus-based aid.

The primary justification for this option reflects the view that the main goal of federal student aid is to provide access to postsecondary education for those with low incomes. In contrast, campus-based aid is less closely targeted toward low-income students than is other federal student aid. In addition, because campus-based aid is tied to specific institutions, students with greater need at poorly funded schools may receive less than those with less need at well-funded institutions.

Postsecondary institutions object to this option, however, because it would reduce their discretion in packaging aid to address the special situations of some students while also reducing total available aid. Moreover, these programs disproportionately help students at private nonprofit institutions (whose students get over 40 percent of this aid, compared with about 20 percent of Pell Grant aid). Thus, cutting campus-based aid would make this type of school less accessible to needy students.

Redirecting half of the savings from eliminating campus-based aid to the Pell Grant program would mitigate the effects of less total aid on lower-income students. The Pell Grant appropriation provides for a maximum award of $2,300 in the 1994-1995 academic year. Redirected funds from campus-based programs could be used by the appropriations committees to increase the maximum Pell grant. Pell grants allow students to choose freely among postsecondary institutions rather than be limited to institutions that offer them campus-based aid. Redirecting one-half of the funds to the Pell Grant program would result, however, in only half the savings that could otherwise be accomplished by eliminating campus-based aid.

DOM-40 REDUCE PELL GRANT SPENDING

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	160	160	170	170	180	840
Outlays	30	160	170	170	170	700

The Federal Pell Grant Program provides grants to undergraduate students based on their financial need. Of all the federal student aid programs, it is the one most directly aimed at low-income students. Spending on Pell grants could be reduced by including house and farm equity in calculating a family's need for financial aid and by eliminating the $5 fee paid to postsecondary school for each Pell grant recipient.

Include House and Farm Equity in Calculating Financial Need. The Higher Education Amendments of 1992 made it somewhat easier for many students to obtain Pell grants by eliminating house and farm assets from consideration in determining a family's ability to pay for postsecondary education. The amount a family is expected to contribute is determined by what is essentially a progressive tax formula. In effect, the need analysis performed for these grant decisions "taxes" family incomes and assets above those amounts assumed to be necessary to maintain a basic standard of living.

This option would include house and farm equity in calculating a family's need for financial aid for postsecondary education. House and farm equity would be taxed at roughly 5.6 percent after a deduction for allowable assets (see ENT-23 for related savings in the Federal Stafford Loan Program). In addition, the threshold below which most families with less than $50,000 in income are not asked to report these assets would also be lowered to its previous level of $15,000.

These two changes together would reduce federal outlays by $600 million during the 1995-1999 period--providing the federal appropriation for the program was cut by the same amount. Families whose houses appreciated during the 1980s are now financially better off than they would have been if they had not owned a house then. At the same time, not counting this equity gives families who own a house an advantage over those who do not.

There is concern, however, that because increases in incomes have not kept pace with increases in housing prices for some families, they might have difficulty repaying their mortgages if they borrowed against the equity in their houses. In addition, having to assess the market values of houses would complicate the application process for many families.

Eliminate the $5 Fee Paid to Postsecondary Schools. Postsecondary schools receive a $5 fee for each Pell grant recipient to help defray the costs of administering the Pell Grant program. Federal outlays could be reduced by an estimated $100 million over the 1995-1999 period if this fee were eliminated and the federal appropriation cut by the same amount. Schools benefit by participating in the Pell program because the grants help pay for the tuition and living costs of their students. Faced with the loss of the Pell grant revenue, however, some schools might increase their tuition or reduce their services slightly, thus producing an unintended negative effect on students.

DOM-41 ELIMINATE THE SENIOR COMMUNITY SERVICE EMPLOYMENT PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	420	430	440	460	470	2,220
Outlays	80	390	430	450	460	1,810

The Senior Community Service Employment Program (SCSEP) funds part-time jobs for people age 55 and older who are unemployed and who meet income eligibility guidelines. Through SCSEP, which is authorized under Title V of the Older Americans Act, grants are awarded to several nonprofit organizations, the U.S. Forest Service, and state agencies. The sponsoring organizations and agencies pay participants to work in part-time community service jobs for about 20 to 25 hours per week, up to a maximum of 1,300 hours per year. The Department of Labor estimates that about 100,000 such jobs would be created under SCSEP in program year 1994.

SCSEP participants work in schools, hospitals, and senior citizen centers and on beautification and conservation projects. They are paid the higher of the federal or state minimum wage or the local prevailing rate of pay for similar employment. Participants also receive annual physical examinations, personal and job-related counseling, and assistance to move into private-sector jobs when they complete their projects. SCSEP is not considered a training program, but in recent years it has put increasing emphasis on preparing its participants for unsubsidized employment. About 20 percent of enrollees move on to such jobs.

Eliminating SCSEP would reduce outlays by about $80 million in 1995 and by about $1.8 billion over the 1995-1999 period. Opponents of the program maintain that it offers few benefits aside from income support, and that the presumed value of the work experience gained by SCSEP participants would generally be greater if the experience were provided to equally disadvantaged young people who have longer careers over which to benefit. In addition, the costs of producing the services now provided by SCSEP participants could be borne by the organizations that benefit from their work; under current law, these organizations bear only 10 percent of such costs. This shift would ensure that only those services that were most highly valued would be provided.

SCSEP, however, is the major federal jobs program aimed at low-income older workers, and eliminating it could cause hardship for older workers who are unable to find comparable unsubsidized jobs. In general, older workers are less likely than younger workers to be unemployed, but those who are take longer to find work. Moreover, without SCSEP, community services might be reduced if nonprofit organizations and states were unwilling or unable to increase expenditures to replace the loss of federal funds.

DOM-42 CONSOLIDATE SOCIAL SERVICE PROGRAMS AND REDUCE THEIR BUDGETS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Reduce Funding by 5 Percent						
Discretionary Spending						
Budget authority	a	120	130	130	130	510
Outlays	a	80	130	130	130	470
Direct Spending						
Budget authority	a	160	170	170	170	670
Outlays	a	150	160	170	170	650
Total						
Budget authority	a	280	300	300	300	1,180
Outlays	a	230	290	300	300	1,120
Reduce Funding by 25 Percent						
Discretionary Spending						
Budget authority	a	620	630	650	670	2,570
Outlays	a	400	630	640	660	2,330
Direct Spending						
Budget authority	a	820	830	830	830	3,310
Outlays	a	770	830	830	830	3,260
Total						
Budget authority	a	1,440	1,460	1,480	1,500	5,880
Outlays	a	1,170	1,460	1,470	1,490	5,590

a. The option would not take effect until 1996.

Social services are provided to many individuals and families through an array of programs, each with its own rules and regulations. These programs may be administered at both the federal and state levels by separate agencies, even though they serve the same or a very similar clientele. In recent years, the number of separate programs has grown, particularly in child care, which has seen five new ones enacted since 1988.

This option would consolidate a number of social service programs into one or more block grants. A large array of programs could be consolidated. For the purposes of this illustrative estimate, the consolidation would bring together the Social Services Block Grant (SSBG), the Community Services Block Grant, Title IV-A "At-Risk" Child Care and Transitional Child Care programs, the Child Care and Development Block Grant, Dependent Care Planning and Development Grants, and grants to states for services and meals from the Administration on Aging. Two block grants--one for each group--might be appropriate if these particular programs continued to provide services primarily to families with young children or to the elderly.

Consolidating these programs and cutting their new budget by 5 percent would reduce federal gov-

ernment outlays by $230 million in 1996 and $1.1 billion over the 1996-1999 period. A 25 percent cut would save $1.2 billion in 1996 and $5.6 billion over the four-year period. Three of the programs that would be consolidated--SSBG and the two Title IV-A child care programs--are entitlements that would affect direct spending. The remaining programs are discretionary and require annual appropriations. To allow time for designing and coordinating consolidation options, particularly the exact set of programs to include, implementation would be delayed until 1996.

With consolidation, localities could provide social services more efficiently. Duplicate services could be eliminated, and administrative costs would decline because of simpler rules and regulations plus a reduction in administrative personnel. States and localities would have more freedom to tailor programs to local needs. Moreover, different services provided to the same individual or family could be coordinated more easily, improving service delivery from the client's perspective.

There would, however, be some risks. Despite improved administrative efficiency, a 5 percent cut in funding could lead to a reduction in services. Several of the programs have state matching requirements, and state spending might decline with their removal. Transitional Child Care is an open-ended entitlement program, and converting it to a capped grant might reduce future funding. Finally, consolidation would diminish federal control over the spending.

A 25 percent cut would have further ramifications. States would be unlikely to replace all or most of the lost federal funding, although those individuals and families who were most in need could be protected, either by directing the consolidated grants toward states and areas with the lowest incomes or fiscal capacities or by federally mandating income limits for eligibility. In addition, because much of the affected spending is for child care subsidies, low-income mothers would find it more difficult to work outside the home, which could increase spending for welfare programs.

DOM-43 REDUCE THE MATERNAL AND CHILD HEALTH CARE BLOCK GRANT AND THE PREVENTIVE HEALTH SERVICES BLOCK GRANT

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	430	450	460	470	480	2,290
Outlays	200	390	450	460	470	1,970

In its appropriations for 1994, the Congress provided about $840 million in block grants for programs in maternal and child health and preventive health services. Almost all of these funds are distributed to the states, with a small amount being used for federal initiatives. The block grants, which are funded through the Public Health Service, allow states considerable flexibility in choosing the programs to fund within the specified areas. These grants do not generally restrict benefits to categories of recipients, such as low-income families.

Each block grant supports a wide range of programs. The Maternal and Child Health Care Block Grant subsidizes programs that provide such services as preventive care, prenatal care, health assessments for children, rehabilitation services for blind and disabled children, and community-based services for children with special health care needs. The 1994 funding for this block grant was $690 million. The Preventive Health Services Block Grant supports programs in areas such as immunization, hypertension control, dental health, environmental health, and injury protection. Funding for 1994 was $160 million.

If funding for each of these block grants were reduced by half, the savings in outlays for the 1995-1999 period would be about $2.0 billion. The principal justification for this reduction is that the federal commitment to other programs directed at maternal and child health and preventive health services has increased substantially in recent years. For example, Medicaid's coverage of low-income women and young children has expanded in several ways. States are now required to provide Medicaid coverage to pregnant women and children under age six in families with incomes below 133 percent of the federal poverty level, and to older children under age 19 and born after September 30, 1983, with family incomes below the poverty line. Thus, the block grants are not essential for ensuring access to health services for these individuals. In addition, states have the option of providing Medicaid coverage for pregnant women and infants in families with incomes up to 185 percent of the poverty line. As of July 1993, 33 states and the District of Columbia had set income thresholds above 133 percent of the poverty line for this population. Similarly, between 1991 and 1993, funding for programs of the Centers for Disease Control and Prevention for immunization, tuberculosis control, human immunodeficiency virus (HIV) prevention, and breast cancer screening increased by $230 million.

The major disadvantage of cutting the block grants is that, in the current fiscal environment, many states might be unable to assume a greater share of the financial responsibility for the programs that are affected. Cuts in the block grants could adversely affect the health of people--especially those in low-income families--who would receive less assistance from these programs.

DOM-44 REDUCE FUNDING FOR RESEARCH SUPPORTED BY THE NATIONAL INSTITUTES OF HEALTH

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	1,130	1,160	1,190	1,220	1,250	5,950
Outlays	490	1,050	1,160	1,190	1,220	5,110

The federal government provided $11.0 billion in 1994 for research funded through the National Institutes of Health (NIH). About 60 percent of the NIH research budget is awarded to universities and other nonprofit institutions through research grants and contracts. The rest is spent on research within the institutes, research contracts with industrial firms, research by state and local governments, foreign research, and administration.

A reduction in funding for NIH research could be justified by its rapid growth in recent years. Between 1983 and 1993, NIH expenditures increased by about 155 percent, or approximately 110 percent after adjusting for inflation. If funds for NIH research were reduced by 10 percent, the 1995-1999 savings in outlays would be about $5.1 billion.

The NIH could respond by limiting its overhead reimbursements for research grants and by funding research projects at a reduced proportion of their costs, thereby encouraging researchers to find additional sources of support (see DOM-57 for a related option). Alternatively, the NIH could cut the number of grants awarded. Since funding of projects is based on a rating system, proposals with the highest ratings would still be supported.

A reduction in NIH funding could, however, have adverse effects on biomedical research and might cause some researchers to leave the field. The NIH cannot currently fund the majority of grants that it approves; in addition, funding is insufficient to support some important areas of research.

DOM-45 REDUCE FEDERAL RENT SUBSIDIES BY SHIFTING SOME COSTS TO THE STATES OR TENANTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Reduce Section 8 Subsidies			
Budget Authority	30	70	160	330	170	760
Outlays	200	450	710	1,020	1,360	3,740
			Reduce Public Housing Operating Subsidies			
Budget Authority	110	230	360	500	640	1,840
Outlays	50	170	290	420	560	1,490

Most lower-income renters who receive federal rental assistance are aided through the Section 8 programs or the public housing program, which are administered by the Department of Housing and Urban Development (HUD). These federal programs usually pay the difference between 30 percent of a household's adjusted income and either the actual cost of the dwelling or, under the Section 8 voucher program, a payment standard. In 1993, average federal expenditures per assisted household for all of HUD's rental housing programs combined were roughly $4,400. This amount includes both housing subsidies and fees paid to administering agencies.

Savings in outlays could be achieved by reducing federal payments on behalf of recipients. To diminish or eliminate the impact of this change on assisted tenants, state governments--which currently contribute no funds toward these federal rental assistance programs--could be required to make up some or all of the decrease as a condition of receiving assistance commitments from newly appropriated funds. This option would increase combined tenant and state rental contributions over a five-year period from 30 percent to 35 percent of a tenant's adjusted income. It would save $200 million in federal outlays for the Section 8 programs in 1995 and a total of $3.74 billion over the 1995-1999 period. Savings in outlays for public housing would amount to $50 million in 1995 and $1.49 billion over the five-year period. Realizing these savings, however, would require changing the authorizing legislation for these programs as well as cutting the annual appropriations for vouchers and public housing operating subsidies. (See DOM-17 for a similar option for the rental assistance program administered by the Farmers Home Administration.)

One rationale for involving states in housing assistance is that these programs generate substantial local benefits, such as improved quality of the housing stock. If all states paid 5 percent of the adjusted incomes of those receiving assistance, housing costs for assisted families would not rise. Moreover, since eligibility for housing assistance is determined by each area's median income, tying states' contributions to renters' incomes would ensure that lower-income states would pay less per assisted family than would higher-income states. Finally, if a state chose not to participate and consequently rental payments by its households increased to 35 percent of their adjusted incomes, those out-of-pocket costs would still be well below the nearly 50 percent of income that the typical nonassisted renter who is eligible for assistance now pays.

Absorbing part of the costs of housing assistance would be difficult for the states that are experiencing fiscal distress, however. Unless all states made up the reduction in federal assistance, this strategy would increase housing costs for some current recipients of aid, who are generally poor. Moreover, raising rental payments could prompt

some stable, slightly higher-income households to leave assisted housing projects in areas of the country where unassisted housing of the same quality would now be cheaper. This outcome would change the economic mix of households in these projects, possibly reduce the projects' viability, and increase the average cost of subsidizing them.

DOM-46 STOP EXPANSION OF THE NUMBER OF RENTAL ASSISTANCE COMMITMENTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	3,850	3,900	4,000	4,150	4,250	20,150
Outlays	10	340	880	1,540	2,420	5,190

NOTE: The CBO baseline does not include budget authority to cover any increases in operating subsidies associated with public housing units to be constructed in the future. Therefore, relative to the CBO baseline, this option does not generate savings in such subsidies.

Each year since 1975, the Department of Housing and Urban Development (HUD) has made new commitments under the Section 8 and public housing programs. These new commitments, which cover periods ranging from five to 20 years, provide rental housing assistance for additional lower-income households, thereby increasing the total number receiving aid. At the end of fiscal year 1993, about 4.6 million commitments for rental assistance were outstanding for all housing programs combined.

Outlays for all rental assistance programs combined totaled more than $20 billion in fiscal year 1993. If those programs are funded for 1995 and thereafter at the rate assumed in CBO's baseline, total outlays will increase to around $26 billion by 1999. Even if no budget authority is appropriated for 1995 and later years for commitments to assist additional households, outlays will rise to more than $23 billion by 1999. That increase will take place because some outstanding commitments have not yet resulted in actual assistance; because subsidies per household increase annually as a result of inflation; and because costs will continue in order to meet such goals as restoring the public housing stock to standard condition and providing incentives to owners of certain housing projects to preserve them for low-income use.

Savings could be realized if the total number of commitments were frozen at the current level. Under this option, enough budget authority would still have to be appropriated to renew all expiring commitments and to fund enough additional ones in each of the next five years to replace commitments that would be lost for other reasons. Incentives to owners to preserve certain rental projects for low-income use would be funded each year at levels estimated by HUD. Modernization of public housing projects would be funded at the 1994 level, adjusted in later years for inflation. This option would reduce outlays by $10 million in 1995 and about $5.19 billion over the 1995-1999 period; additional savings would accrue for up to 20 years thereafter, when all contracts associated with 1995-1999 budget authority would have expired. (See DOM-17 for a similar option for the rental assistance program administered by the Farmers Home Administration.)

An argument in favor of this option is that expanding rental assistance programs is inappropriate in light of present cutbacks in other areas. Furthermore, existing commitments would continue to assist many new income-eligible households each year because of turnover among assisted renters. Finally, no current recipients would lose their housing assistance as a result of this option.

An argument against the option is that the upward trend in the proportion of eligible renters actually receiving assistance has almost leveled off at about 30 percent because the number of new commitments funded annually dropped significantly during the 1980s. If the number of commitments were frozen, the proportion of eligible renters receiving assistance would fall because of continued growth in the number of eligible households. As a result, the problem of homelessness might worsen.

DOM-47 SHIFT HOUSING ASSISTANCE FROM NEW CONSTRUCTION TO VOUCHERS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
	Replace New Construction with Vouchers					
Sections 202 and 811						
Budget authority	1,100	1,150	1,150	1,200	1,250	5,850
Outlays	-5	-35	-10	85	340	375
Public Housing[a]						
Budget authority	530	540	560	570	590	2,790
Outlays	b	-15	75	185	325	570
	Partially Replace New Construction with Vouchers					
Sections 202 and 811						
Budget authority	560	570	580	600	620	2,930
Outlays	b	-20	-5	40	170	185
Public Housing[a]						
Budget authority	260	270	280	290	290	1,390
Outlays	b	-5	40	90	160	285

a. The CBO baseline does not include budget authority to cover any increases in operating subsidies associated with public housing units to be constructed in the future. Therefore, relative to the CBO baseline, this option does not generate savings in such subsidies.

b. Increase in outlays of less than $2.5 million.

A number of federal programs administered by the Department of Housing and Urban Development (HUD) subsidize the housing costs of lower-income households. The programs provide rental assistance through two basic approaches: subsidies that are tied to projects specifically constructed for lower-income households and subsidies that enable renters to choose standard housing units from existing private housing. Since the early 1980s, construction of low-income housing has been sharply curtailed in favor of using less costly existing housing. The only construction programs under which new commitments are still being made are the Section 202 and Section 811 programs (for the elderly and disabled, respectively) and the public housing program. For 1994, about one-third of additional assistance commitments are for construction of new dwellings, and the remaining ones are provided through the Section 8 existing-housing certificate and voucher programs.

Appreciable savings in the costs of housing programs could be realized by substituting vouchers for new construction. Total savings over the long run are evident when the cost of using vouchers is compared with the cost of new construction in terms of their present values, but not necessarily evident when they are compared in terms of year-by-year outlays as reflected in the budget. (Present values indicate the amounts of money that would have to be put in the bank today in order to cover the future streams of costs.) This apparent contradiction occurs because of differences in the patterns of outlays for the two approaches. Construction programs require large up-front federal outlays for building the projects, with relatively low annual outlays for

operating subsidies thereafter. In contrast, annual outlays for vouchers are more constant over time but exceed those for annual operating subsidies.

The options shown here would eliminate new commitments for construction, or make only half as many, and in each case replace the eliminated commitments with vouchers on a one-for-one basis. The savings shown in the table are not measured in terms of present values, however, because of budgetary conventions. Nevertheless, the budget would show net savings in outlays over the 1995-1999 period for each of the options considered. Under the first option, outlays would decrease by $375 million for the Section 202 and Section 811 programs and by $570 million for the public housing program. Net savings under the second option would be half of those amounts. These savings reflect the elimination of up-front construction expenses. Under both options, savings in outlays would continue to occur for some time after 1999, but eventually the budget would reflect the higher annual outlays of vouchers compared with operating subsidies.

Substantially greater savings in budget authority would occur over the five-year period, but again, these short-term savings do not represent the complete picture. For example, in the Section 202 and Section 811 programs, the savings would derive partially from the shorter contract term of vouchers (five years) compared with rental assistance in the newly constructed projects (20 years). Consequently, they would be offset by higher budget authority after 1999, if expiring vouchers were renewed for 15 more years. (In the calculations of present values, on which the earlier discussion was based, this difficulty was avoided by using the same period of time for both types of aid.)

Proponents of these options see little need for subsidizing new construction. The overwhelming housing problem today, they argue, is not a shortage of rental units but the inability of poor households to afford existing units. For example, nationwide vacancy rates have consistently exceeded 7 percent since 1986, the highest levels since 1968. Furthermore, even if there are shortages, subsidizing new construction may merely displace private activity rather than add to the total housing stock. Also, the construction of subsidized housing is generally a slow process that, at best, has an impact only after a long lag. Vouchers could help the poor more quickly and at a much lower cost to the federal government than would new construction. In addition, vouchers would give the poor greater flexibility in choosing where to live.

National statistics on the supply of rental units, however, may mask local shortages of certain types of units that rent within HUD's guidelines for vouchers. Many elderly and disabled households, in particular, need housing that can provide special social and physical services that are not available in their current residences. Supporters of subsidized construction of units for elderly and disabled households contend that the private sector does not respond adequately to these demands because it produces units that those with low incomes typically cannot afford, even when vouchers subsidize rents. Similarly, a relatively large proportion of lower-income families with children live in crowded conditions. Many of them need units with three or more bedrooms. A number of the nation's large public housing authorities report that their jurisdictions have shortages of these large units with rents within the HUD guidelines.

DOM-48 MODIFY THE FEE STRUCTURE FOR LOCAL AND STATE AGENCIES THAT ADMINISTER FEDERAL HOUSING PROGRAMS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	70	70	110	200	90	540
Outlays	190	210	240	280	310	1,230

The Department of Housing and Urban Development (HUD) pays fees to local and state public housing agencies (PHAs) for administering the Section 8 existing-housing certificate and voucher programs. For each assisted household, PHAs receive an ongoing annual fee and a one-time fixed fee when the new assistance commitment from HUD is first issued. Under current policy, the annual fee for commitments funded from pre-1989 appropriations ranges from 6.5 percent (for vouchers) to 7.65 percent (for certificates) of the local two-bedroom fair market rent (FMR). The fee for commitments funded from appropriations since 1989 is 8.2 percent for both programs. The ceiling for the one-time fee is now typically $275 for each new commitment.

A 1988 study based on data from a sample of large urban PHAs estimated that annual administrative costs for both the existing-housing certificate and voucher programs averaged about 5 percent of the two-bedroom FMR. The average start-up costs, however, amounted to about $590 per household. Changing the current fee structure to reflect these estimated costs would reduce federal outlays by $190 million in 1995 and by $1.23 billion over the 1995-1999 period. In general, realizing these savings would require changing the authorizing legislation as well as cutting the appropriations for vouchers to reflect the lower fee payments. Even greater savings might be realized if other private or public entities were allowed to compete with the PHAs for the administration of the programs.

Such a fee structure would more accurately reflect the best available information about the costs of providing these types of housing assistance. Moreover, this option would equalize fees for programs that appear to have similar administrative costs and would eliminate the disparity among fees, which now vary according to the year the commitment was first funded. In doing so, the fees would also be easier to administer. Allowing other organizations to compete to administer these programs might lead to increased efficiency.

This option could, however, lead to financial difficulties for some PHAs. For example, in areas where FMRs are low relative to the overall cost of living, reduced fees might not cover actual administrative costs. Also, some PHAs may now use their excess reimbursements to cover shortfalls in the funds for other subsidized housing programs that they administer. (Such problems would be exacerbated if the administration of certificates and vouchers were taken over by other organizations.) Moreover, it is unclear whether the study on which these estimated costs are based can be generalized. Smaller urban and rural PHAs may have patterns in their administrative costs that differ from those of the large urban PHAs covered by the study. Thus, some further modifications in the fee structure might be necessary, and that could change the ultimate federal savings.

DOM-49 ELIMINATE OR SCALE BACK LOW-INCOME HOME ENERGY ASSISTANCE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Eliminate Program			
Budget Authority	2,100	2,150	2,200	2,250	2,350	11,050
Outlays	1,400	1,500	1,550	1,600	1,650	7,700
			Scale Back Program			
Budget Authority	1,050	1,050	1,100	1,150	1,150	5,500
Outlays	700	760	780	800	820	3,860

NOTE: The CBO baseline includes $600 million of budget authority in fiscal year 1995 and $3.2 billion during the 1995-1999 period that is contingent on the President's designation of an emergency. In addition, the savings shown for 1995 and 1996 would require a rescission of part or all of the $1.475 billion advance appropriation in the 1994 appropriation act.

The Low Income Home Energy Assistance Program (LIHEAP) helps pay the home energy costs of some low-income households. Authorized by the Omnibus Budget Reconciliation Act of 1981 and administered by the Department of Health and Human Services, LIHEAP funding for block grants to states was $2.0 billion in 1994. States may use the grants to help eligible households pay their home heating or cooling bills, meet energy-related emergencies, or fund low-cost weatherization projects.

Households may be eligible if they receive assistance from certain other programs, such as Aid to Families with Dependent Children or Supplemental Security Income, or if their incomes are low. In addition, federal law requires that states give preference to households with the highest energy costs (relative to income) when disbursing LIHEAP funds. Only about one-third of eligible households actually receive assistance.

Eliminating LIHEAP would save $7.7 billion in federal outlays during the 1995-1999 period. Scaling back future appropriations by 50 percent would reduce outlays by about half that amount.

LIHEAP was created in response to the rapid increases in the price of energy used in the home in the late 1970s and early 1980s. Since its enactment in 1981, real prices of household fuels have declined by 20 percent, although they remain somewhat above their early-1970s levels. These lower real prices might now warrant either eliminating or reducing LIHEAP. Moreover, 31 states transferred up to 10 percent of their LIHEAP funds during fiscal year 1992 to supplement spending on five other social and community services block grant programs; the transfers indicate that some states believe that spending for energy assistance does not have as high a priority as other spending. (This authority to transfer funds is no longer available.)

The most recent LIHEAP appropriation, however, is 33 percent below the program's original 1981 level of funding in real terms, a larger decline than the drop in real prices of household fuels. Moreover, the appropriation includes $600 million that cannot be spent unless the President designates an emergency. If no such designation is made (and none was made in 1993), the real decline in LIHEAP would be 52 percent. Additional reductions would create hardships for some low-income households, forcing them to choose between paying for energy or for other household necessities. A further argument for retaining LIHEAP at some level is the flexibility it provides to respond quickly to a future spurt in energy prices.

DOM-50 CLOSE OR CONVERT INEFFICIENT OR UNDERUSED FACILITIES IN VETERANS' HOSPITALS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Budget Authority	80	170	260	350	360	1,220
Outlays	70	155	245	340	360	1,170

The Department of Veterans Affairs (VA) operates a nationwide medical care system that in 1993 included 171 hospitals with 55,000 inpatient beds, 131 nursing homes, and 371 outpatient clinics. Most of the hospitals are large, modern, and well staffed, providing access to high-quality care for eligible veterans. Although many of the hospitals are treating increasing numbers of patients, other facilities have experienced a declining demand for services, such as major surgery or common acute care procedures. In response, the VA in 1994 plans to open additional nursing home beds that have been converted from hospital beds.

The VA could achieve greater efficiency by closing small hospitals or underused units within hospitals or by converting them into facilities that offer services in greater demand. The criteria for closure could include the existence of adequate alternative sources of care, as well as low numbers of veterans using the VA facilities. Carrying out this option would require changes in both the program's authorization and its appropriation.

The level of savings that could be achieved would depend on several factors: whether complete hospitals or merely wings within hospitals were closed or converted; whether conversions substituted for new construction that would otherwise have occurred; and the extent to which gross savings from closure or conversion would be absorbed by the increased costs for transportation or private care incurred for some veterans under the restructured arrangements. If overall savings were equal to those from the gradual closing of 4 percent of VA hospital beds, federal savings would total about $1.2 billion from 1995 through 1999.

This option would reduce the number of expensive surgical and other acute care medical facilities with low rates of use or occupancy. Closing or converting these facilities would not eliminate VA care for veterans--patients would be transferred to other VA hospitals or appropriate private facilities--but needed care would be provided more economically. To the extent that veterans were transferred to facilities that had greater professional resources or that undertook relevant surgical procedures more frequently, closure or conversion would also improve the quality of the care that veterans received.

This option could have the effect, however, of reducing access to health services for some veterans who receive care on a space-available basis within underused VA facilities. Some veterans might also find care more difficult to obtain if closures in rural areas without other facilities required them to travel greater distances to receive care.

DOM-51 REDUCE FUNDING FOR LAW ENFORCEMENT EFFORTS TO CONTROL ILLEGAL DRUGS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	1,700	1,750	1,800	1,900	1,950	9,100
Outlays	1,100	1,500	1,750	1,850	1,900	8,100

The federal government currently allocates over $12 billion to the war on drugs. Of that amount, about $7.6 billion is for law enforcement activities, including $2.6 billion for courts and prisons, and $5.0 billion directed toward controlling the supply and distribution of illegal drugs in this country. The remainder is allocated to research and development, treatment, education, and other efforts to control the demand for drugs. Interdiction and international activities account for $1.7 billion of the funds designated for efforts to control the supply of drugs. Since 1988, total federal resources aimed at controlling the drug supply have grown by about 70 percent, after adjusting for inflation.

The results of this formidable effort have been mixed, and both supporters and detractors of current law enforcement activities can find encouragement in recent trends. Some indicators show that drug use is significantly less prevalent than it was before the inception of the war on drugs, while other measures show that there has been no decline among certain important subgroups, especially hard-core users. With no clear proof of the efficacy of law enforcement efforts against drugs, some critics argue that the federal government could drastically reduce the resources directed toward the problem without affecting drug use over the long term. A 33 percent cutback in annual appropriations for supply-side efforts, phased in over three years, would save $8.1 billion in outlays over the 1995-1999 period; the amount remaining after the cut would still be greater, in constant dollars, than the funds allocated in 1988.

An alternative method of achieving these savings would be to direct reductions at specific aspects of drug control instead of making an arbitrary, across-the-board cut. Under this option, all of the savings would be gained by reducing interdiction and international activities, the two efforts for which critics find the most questionable results. The Congress has already moved to scale back funding for these activities, with the result that their appropriations for fiscal year 1994 were over 40 percent lower than the 1992 level in constant dollars.

Deriving the entire savings from interdiction and international activities would entail nearly eliminating them--and not only those conducted by nondefense agencies but those of the Department of Defense as well. Defense-related efforts account for about one-fourth of interdiction and international activities, and efforts related to the administration of justice account for about two-fifths. The remainder is split between the budget functions for transportation and international affairs. This option would leave unchanged the funding for treatment, education, and other activities focused on controlling the demand for drugs. It would also facilitate the stated Congressional goal of achieving parity between funding for law enforcement activities and initiatives that reduce the demand for drugs.

Proponents of reducing federal spending for interdiction and international activities argue that these efforts have not and cannot have a lasting effect on either the availability of or the demand for drugs. They have undoubtedly made it more difficult and more costly to grow, process, import, and distribute illegal drugs; but no hard evidence exists to support the hypothesis that intensified efforts have kept these drugs away from users or pushed prices up to levels that, in the long run, appreciably reduced the amount of drugs being purchased. In fact, some sources show that illicit drugs are less expensive and more readily available now than they were before the inception of the war on drugs.

In addition, current research shows that efforts to cut off the supply of drugs in the country of origin are not cost-effective, because at that point the producers have incurred only minimal costs. As drugs proceed further along the processing and delivery chain, disruptions cause greater financial hardship for the dealer and, one assumes, produce a greater deterrent effect. This evidence suggests that, to use law enforcement dollars to the greatest advantage, efforts should focus on the later stages of drug supply, particularly at the street level, where responsibility rests with state and local units of government. Of course, efforts to control the supply of drugs at that level are tenuous for several reasons: competition among producers and distributors, the large markup from wholesale to retail prices, and the ability of distributors to dilute the drug and so maintain an end price that customers can afford.

Proponents of cutbacks in law enforcement efforts also argue that factors related to demand, rather than supply, are dominant in determining drug use. In the past 10 years, the supply of drugs has actually increased; yet most measures of substance abuse have shown significant declines, including lower levels of serious drug use and reductions in the number of people needing treatment. Although causality cannot be assigned, one could argue that the declines are independent of the level of federal resources allocated to controlling drug use. Proponents of reducing enforcement efforts claim that perceptions of health risks and societal attitudes, not enforcement, have probably reduced the demand for drugs among casual users. They also argue that stepped-up levels of enforcement could not have controlled past increases in the number of people with serious drug problems because hard-core users tend to become immune to such efforts. Instead of more enforcement, proponents argue for an expansion or reshaping of existing drug education and treatment programs and for more attention to societal problems, such as dysfunctional families, that contribute to overall drug use.

Those opposed to cutting funds for drug enforcement and related efforts point to the successful side of these activities: the destruction of major drug trafficking organizations and the large quantities of illegal crops and drugs that have been destroyed or seized. Law enforcement planners believe that they can take some credit for the reductions seen in drug use since its apex in the mid-1980s; they argue that street prices would have been much lower, and the availability of drugs much greater, without extensive funding for criminal justice efforts. Given that overall drug use remains at unacceptably high levels and that some indicators show recent increases in some categories of use, they contend that it would be premature and irresponsible to reduce or shift current resources away from enforcement. They point out, moreover, that criminal justice efforts are needed as much to keep some control over illegal drug activity as to reduce it, and that many programs are hard-pressed to maintain their existing levels of effort even with current funding. For some agencies, cutting back their funding for interdiction and international efforts would also disrupt some of their activities that are not related to combating the use of drugs.

DOM-52 REDUCE FUNDING FOR JUSTICE ASSISTANCE AND CERTAIN JUSTICE-RELATED ACTIVITIES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	280	280	290	300	310	1,460
Outlays	140	220	280	290	300	1,230

In addition to the law enforcement activities that the Department of Justice (DoJ) carries out directly, it and related government entities provide various types of law enforcement or legal assistance to individuals, community organizations, and state and local law enforcement agencies. That assistance can take the form of direct payments to individuals; financial grants to carry out projects or conduct research; provision of information, training, or services; or in-kind grants. This option would reduce direct financial assistance by 20 percent while removing many of the restrictions on the use of these grants. In addition, it would reduce funding for the Legal Services Corporation (LSC) by 30 percent and terminate the State Justice Institute (SJI). These cuts can, of course, be considered separately.

In 1994, the federal government will provide state and local units of government and nonprofit organizations with justice assistance grants totaling nearly $700 million. (That figure constitutes an increase of 135 percent since 1988, after accounting for inflation.) This financial assistance is spread among many grant programs, each earmarking funds for a specific purpose. Consolidating those grants into one large formula grant for justice-related activities and reducing the total funding by 20 percent would generate outlay savings of $30 million in 1995 and $0.5 billion through 1999. For 1994, the Congress appropriated $400 million to fund the LSC and $14 million to fund the SJI. Reducing funding for those two organizations as described below would save $110 million in 1995 and $0.7 billion over the 1995-1999 period.

Reduce and Consolidate Direct Financial Assistance. The DoJ will provide grants to states and localities totaling $680 million in 1995, virtually all of which is distributed through the Bureau of Justice Assistance. By far the largest of those programs is the Anti-Drug Abuse Grants program, which accounts for about $475 million of the total. Other grants fund juvenile justice programs; support research, development, and evaluation of state justice programs; assist in the settlement of Cuban and Haitian immigrants; or fund various other initiatives. Grants are classified and administered as either program grants, which are awarded to government or nonprofit groups based on competitive applications, or formula grants, which allocate funds on the basis of population and other characteristics of the states.

Critics of federal spending for law enforcement assistance argue that DoJ directs much of its funding toward problems that are of low priority to recipient governments or that are not federal responsibilities. They also contend that resources are used inefficiently and that with some modification, financial assistance could be scaled back substantially with no detrimental effects on the nation's law enforcement capabilities. The reductions contemplated by this option would entail consolidating the programs and changing the method by which monies are allocated. Most DoJ grants are categorical grants, which must be used for a specific purpose and in some cases require the receiving entity to provide matching funds. Specifying the grant's purpose could encourage units of government to spend money on programs that may not be a high priority in their jurisdiction. (From that point of view, applicants take grants because they are available rather than because of pressing need.) In contrast, block grants are dedicated to a broad category, and recipients are allowed to direct resources toward the programs within that category where they need

them the most. Shifting the method of distributing funds exclusively to block grants would enhance the ability of localities to handle their law enforcement problems, even with fewer total resources.

Those in favor of restructuring the federal government's grant programs also point to potential savings from lower administrative costs. Currently, each program grant requires that applicants file a proposal detailing how the grant will be used and what oversight will be conducted; in addition, recipients must submit follow-up reports on the program's achievements. Those administrative expenses absorb a portion of the total grant that could be used to carry out program activities by administering the entire program as a single formula grant. This plan is consistent with recommendations in the National Performance Review for reducing administrative overhead and enhancing flexibility.

Opponents of reducing funding for law enforcement point to the vital role of the federal government in augmenting the resources of the states and directing funds to areas of critical national need. In certain cases, they argue, the problems that these monies are addressing are national in scope; without the incentive of federal grants, the states might neglect those problems because of the scarcity of their resources. For example, state and local law enforcement agencies use the Anti-Drug Abuse Grants for street-level drug enforcement, and in 1991, that one program accounted for roughly 10 percent of such spending by all levels of government. Without federal assistance, these advocates assert, the nation's streets would be far more dangerous than they already are. With crime rates soaring around the country, they argue that there should be more, rather than less, federal money allocated to battling crime.

Other areas, such as juvenile justice, also rely heavily on federal assistance for support. In many cases, states supplement federal funds with their own resources, thus raising the total level of resources directed at the problem. Reducing federal funding for these efforts would cause many of the states to terminate their programs and allocate their funds to other purposes. Proponents of the current categorical grant system maintain that if such grants are used effectively, they can provide the necessary incentive for states to address problems that federal lawmakers feel are most pressing. These advocates argue that the purpose of the grants is not to provide the resources for law enforcement efforts at all levels of government but to persuade states and localities to address problems that they otherwise might not. The federal effort to persuade states to enhance their civil rights protections is an example of how this practice has operated in the past.

Reduce Funding for the Legal Services Corporation and Terminate the State Justice Institute. The Legal Services Corporation is an independent, not-for-profit organization that supplies funding to programs providing free legal advice to the poor on civil matters. About 300 state and local programs receive LSC grants from federally appropriated funds, and in 1992 these programs handled about 1.4 million cases. Since its inception in 1974, the LSC has been the subject of controversy. Critics such as the American Farm Bureau Federation charge that the activities of legal service lawyers too often focus on advancing social causes rather than on meeting the needs of poor people with routine legal problems; they also question the appropriateness of some of the tactics employed by LSC attorneys. In addition, such critics argue that providing legal services to the poor is not a federal responsibility. Reducing the LSC's funding by 30 percent would severely restrict its ability to furnish such services, including those that critics find objectionable.

Those people in favor of continued support for the LSC argue that the federal government's funding of free legal services for poor people is the only way to ensure that all citizens receive legal representation, regardless of their financial situation. Removing federal funding in favor of support from private sources and pro bono services would diminish access to legal services. Proponents of the LSC argue that relying on uncertain and indirect forms of assistance, rather than on a specifically targeted program of federal assistance, is insufficient protection; the inadequacy of local and private support was one of the factors that led to direct federal financing in the first place. Moreover, the reduction in funding might be at the expense of exactly those services that the Congress would like to see continued. In addition, they point out that criticisms of

the LSC have subsided in the past few years as a result of its eliminating some of its more controversial activities. Advocates argue that thorough oversight and clear definition of permitted activities would further curtail the activities that some observers find objectionable while still achieving the LSC's purpose.

The State Justice Institute was established in 1984 as a private, not-for-profit corporation to provide grants and undertake other activities to improve the administration of justice in the states. Although the President proposed terminating this program in 1994, the Congress appropriated $14 million for it. According to critics, the SJI has a negligible impact on the functioning of state justice systems. Most of its grants support research on improving the administration of justice, particularly the courts, but the SJI does little to disseminate or spur implementation of the results of those studies. The SJI's funds would be more effective if they were used to aid justice systems in implementing ideas that have been shown to work, rather than to produce more research. SJI opponents argue that the institute has no effect on how justice systems function and that terminating it would cause no noticeable decline in services. It would, however, produce savings of $5 million in 1995 and $55 million through 1999.

SJI proponents argue that it is a useful source of new ideas for improving state justice systems and a forum for officials of different state and federal agencies to exchange innovative ideas. They point to useful projects that the institute has funded, such as the one that reduced the length of trials in San Jose from eight days to four, as examples of how the SJI's work has improved the administration of justice. Proponents further assert that the SJI is one of only a few institutions that focus on the courts, a critical element in any criminal justice system. They argue that without enhanced court administration, improvements in other areas of law enforcement cannot achieve their full potential.

DOM-53 CHANGE OVERTIME PRACTICES FOR CERTAIN MANAGERS AND SUPERVISORS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	35	55	80	85	90	345
Outlays	35	55	80	85	90	345

NOTE: Because agency contributions to federal employee retirement trust funds are based on basic pay, the proposal does not affect those contributions.

Managers and supervisors engaged in criminal investigation may charge the government for overtime, without prior permission. Other managers not involved in law enforcement, although entitled to overtime, generally put in the hours necessary to complete their work without receiving extra pay. (In addition, for these other managers, paid overtime must be approved in advance.) If the government discontinued special overtime practices for managers and supervisors engaged in criminal investigation, the savings in outlays over the 1995-1999 period would be $345 million.

About 33,000 federal employees, 5,000 of them managers and supervisors, may receive compensation for this special overtime, known formally as administratively uncontrollable overtime (AUO). Most such employees are criminal investigators working in agencies like the Federal Bureau of Investigation, the Drug Enforcement Administration, the Internal Revenue Service, and the Customs Service. The government's practice of compensating employees for AUO recognizes that for workers in law enforcement, failing to continue working past normal quitting times may jeopardize public safety. Moreover, obtaining prior approval for overtime in the area of law enforcement is not always practical. (The example of a stakeout illustrates this point.) But for managers and supervisors in law enforcement, it is reasonable to assume that a significant amount of the work charged to overtime covers the same general management activities that other managers frequently perform without extra pay. Managers and supervisors who are eligible for AUO almost always take the maximum allowed--25 percent of base pay--which suggests that this practice may have become a hidden salary supplement.

Those observers who argue for keeping AUO point out that cutting back overtime for managers and supervisors could mean that some would make less than their subordinates, who would continue to be reimbursed for extra hours on the job. They also note that some criminal investigators may be reluctant to take management jobs if AUO is not available. If it becomes evident, however, that base pay is inadequate to meet the government's recruitment and retention needs, an option would be to reform salary schedules rather than cover the deficiency through overtime practices. A mechanism already exists for such an adjustment: the Federal Employees Pay Comparability Act of 1990 provides authority to establish pay systems designed around the special needs and circumstances of law enforcement occupations.

Another point that some critics raise is that, far from being a pay supplement, AUO may actually be a bargain in cases in which employees put in many more hours than the number needed to equal the maximum overtime compensation of 25 percent of base pay. In addition, some agency officials argue that if AUO is abolished, a portion of that overtime may be charged to the government under other authority covering overtime that agencies order and approve. (The estimates for this option have been reduced to reflect some reprogramming of overtime hours.)

DOM-54 CUT SALARIES OF FEDERAL CIVILIAN EMPLOYEES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Budget Authority	1,750	1,850	1,450	1,200	1,000	7,250
Outlays	1,700	1,850	1,450	1,250	1,000	7,250

NOTE: Savings exclude reductions in agency contributions to federal employee retirement trust funds because those reductions do not affect the deficit.

In 1993, the payroll for the government's 2.3 million civilian employees in all three branches of government totaled about $85 billion, or roughly 6 percent of total federal outlays for the year. (These figures do not include postal workers.) In the past, largely in response to budgetary pressures, the government has acted to reduce federal personnel costs, and the Congress could take such action again. This option describes one of many possible approaches.

Under the Federal Employees Pay Comparability Act of 1990 (FEPCA), federal white-collar workers may receive two pay adjustments at the start of each year. The first is meant to keep federal salaries abreast of changes in the cost of living, as measured by the employment cost index (ECI). The second is intended, over a period of nine years, to close gaps between federal and private-sector rates from locale to locale. If the government, in January 1995, skipped the scheduled ECI adjustment, the savings in federal outlays over the 1995-1999 period would total $7.3 billion. This approach would, in effect, represent a deferral of raises because skipping ECI adjustments now could result in higher locality adjustments in later years. (Such an effect is reflected in the estimates. They also represent only savings in discretionary spending. The estimates do not include the mandatory savings that would result if this option were applied to Members of Congress and judges.)

Limiting the growth of salaries of federal employees may be viewed as part of a general belt-tightening brought on by the federal budget deficit. Such constraints on spending are not confined to the federal government; financially strapped firms in the private sector and local governments have been forced to cut personnel costs through layoffs, pay limits, or other measures. In the past, limits on pay would have raised major concerns about the ability of the federal government to recruit and retain workers. But such concerns appear less urgent with personnel reductions already under way at the Department of Defense and other agencies. Should the government experience trouble in hiring and keeping the workers it needs, FEPCA offers a means to provide allowances, bonuses, and special pay rates that could help agencies deal with the worst of such problems. (The savings in outlays listed in the above table assume that FEPCA clauses would not be activated.)

Limiting the pay of federal workers, however, raises questions of fairness and worker morale when viewed in the light of the sacrifices that federal employees have already made on behalf of the budget. Prior to the enactment of FEPCA, federal employees were entitled to annual adjustments under procedures that compared federal and private-sector salaries nationwide. Yet in 1986, no raise was allowed; in most other years, the increase was well below the level needed to achieve comparability with the private sector. Moreover, restricting pay would represent a revival of the same kinds of practices that led to the need for FEPCA and would undercut that long-deliberated reform. Data collected for FEPCA show that federal rates lag behind comparable private-sector rates: after years of pay limitation, federal workers, on average, are

paid from 20 percent to 40 percent less, depending on the location. Although the government has not yet experienced wide-ranging recruitment and retention problems, a revival of the practice of chipping away at federal pay rates that are already uncompetitive would be likely to hurt efforts to recruit and keep good workers in the future.

DOM-55 CHARGE FEDERAL EMPLOYEES COMMERCIAL RATES FOR PARKING

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	100	100	110	110	110	530
Outlays	100	100	110	110	110	530

The federal government leases and owns more than 200,000 parking spaces, which it allocates to its employees--in most cases, without charge. Requiring employees of the federal government to pay commercial rates for their parking could reduce the deficit by $100 million in 1995 and by $530 million in the 1995-1999 period.

The vast majority of federal workers park without charge. For example, one survey of 10 agencies in Washington, D.C., found that 71 percent of federal workers who receive parking from their agencies receive it free of charge. Employees of the Congress also receive free employer-provided parking. Those federal workers who do pay for parking are almost always charged less than the commercial rate, although federal agencies, with the approval of the General Services Administration, are allowed to charge their employees the higher commercial fees. Some Members of Congress support charging all federal employees parking fees set at commercial rates, an idea similar to a proposal made by President Carter. The Clinton Administration has also proposed greater incentives for agencies to charge higher rates for parking.

Federal workers in the largest metropolitan areas would bear the brunt of these new charges. Those in the Washington, D.C., metropolitan area would be most affected, paying about 75 percent of the total charges. Federal installations in less commercially developed areas--where charging for parking is unlikely to be a commercial practice--would not face new fees. This estimate relies on the best available information about the number of federal parking spaces, commercial parking rates, and expected declines in the demand by federal workers for parking as a result of higher rates. Once commercial rates were instituted, however, future charges for parking, the number of spaces that the federal government would control, and responses by federal workers could vary unexpectedly.

In 1992, the Congress passed an energy policy law that included a provision to include as taxable income the commercial value in excess of $155 per month (indexed for inflation beyond 1993) for any parking provided free of charge by an employer--including the federal government. Paying at commercial rates for parking would reduce the gross income of such employees; however, the estimate of savings from this option does not include the reduction in tax revenues that would result, because available data do not allow an estimate of the option's effect on revenues. Analysts agree that the offsetting reduction in revenues would be relatively small.

Proponents of charging commercial rates for employer-provided parking argue that subsidized parking increases the frequency with which workers drive to work, especially in single-occupancy vehicles. These observers believe that higher prices for parking would decrease the flow of cars into urban areas by encouraging the use of public transportation or car pooling. In turn, they argue, a reduction in the number of cars would reduce energy consumption, air pollution, and congestion.

Some supporters of charging fees also maintain that the federal government could call more effectively on others to reduce pollution and energy consumption if its own workers took steps to achieve those goals. In addition, charging commercial prices for parking would show more accurately the demand for parking by federal workers. At commercial rates, the supply of employer-provided parking may well exceed demand, which could lead to alternative uses of federal space. Moreover,

commercial pricing would allocate spaces to those who value them the most, setting aside differences in income. Finally, some observers argue that the federal government can no longer afford to provide valuable goods and services free of charge to workers who can afford to pay for them.

Opponents of full-cost pricing for parking argue that it would unfairly penalize workers in urban areas who do not have ready access to alternative transportation or who drive to work for valid personal reasons. In the view of these individuals, charging commercial rates for parking for federal workers effectively represents a cut in total compensation and is particularly inappropriate, they contend, in the face of other proposed reductions in federal employment and compensation. Some critics have also argued that free parking is a common form of compensation in the private sector. (In the Washington, D.C., metropolitan area, however, in 1991, only 37 percent of parking spaces for private-sector workers were provided free of charge; 46 percent of spaces at nonfederal facilities were priced at the full commercial rates.) In addition, some people argue that the new charge will simply change which federal employees use the parking spaces. Now, the allocation of parking spaces in many agencies is based on rank, seniority, or other factors; instituting fees for parking would ration spaces by employee demand.

If the funds collected from charging commercial rates for parking were used to finance other spending, the savings noted earlier in this option would be smaller or zero. The Administration, for example, has supported new incentives for agencies to charge higher rates for parking in order to subsidize the use of mass transit by their workers. That proposal would neither reduce nor enlarge the deficit because agencies would not rebate the fees to the Treasury but instead provide them to transit-using employees. The funds raised by this option would be counted as offsetting collections or offsetting receipts, depending on how the option was applied.

DOM-56 REDUCE THE NUMBER OF POLITICAL APPOINTEES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	80	80	30	70	100	360
Outlays	75	80	30	70	100	355

NOTE: Savings exclude reductions in agency contributions to federal employee retirement trust funds because those reductions do not affect the deficit.

Generally, the term "political appointee" refers to employees of the federal government who are appointed by the President, some with and some without confirmation by the Senate, and to certain policy advisors. For the purposes of this option, the term covers cabinet secretaries, agency heads, and other "executive-schedule" employees at the very top ranks of government; top managers and supervisors who are noncareer members of the Senior Executive Service; and confidential aides and policy advisors who are referred to as Schedule C employees. Total employment in such positions, according to CBO projections, will average about 2,900 over the next five years. If the government capped the number of political appointees at 2,000, savings over the 1995-1999 period would total $355 million. The average 1995 salary for political appointees in this calculation is estimated to be $68,000. (The employment and savings projections presented here do not cover ambassadors, who, CBO assumes, would be exempt from the suggested cap on employment.)

The National Performance Review (NPR) called for reductions in the number of federal managers and supervisors but made no conscious effort to include those managers and supervisors who were political appointees. Yet the argument that the NPR puts forth for reducing the number of government managers--that they add to organizational layering and complexity and therefore stifle initiative and limit flexibility--also applies to top managers who are political appointees. In the same vein, the National Commission on the Public Service, also known as the Volcker Commission, called for limits on the number of political appointees similar to the one described here. In addition to the problem of excess organizational layering, the commission described concerns associated with the lack of expertise in government operations and programs that characterizes many appointees. In political appointments, the commission noted, more weight is often given to political loyalties than to knowledge of government. Moreover, few appointees are in office long enough to acquire the necessary skills and experience to master their jobs. That lack of experience, wrote the commission, means that political appointees frequently are not effective in carrying out the policies of the President they serve and can disrupt the day-to-day operations of agencies. Another consequence is that career managers become frustrated and demoralized, making recruitment and retention at the top ranks of the career civil service difficult.

Those observers who defend the use and proliferation of political appointees cite the importance for a President of establishing control over the vast bureaucracy by having like-minded individuals and allies strategically located throughout the government. These appointees, supporters note, form an important link to the electorate because they help to ensure leadership throughout government that is consistent with the philosophy of each elected President. Such appointees, moreover, can be a source of fresh perspectives and innovation. The high rate of turnover among many appointees, supporters argue, means that officials make way for someone new before they reach the point of "burnout."

DOM-57 REDUCE THE OVERHEAD RATE ON FEDERALLY SPONSORED UNIVERSITY RESEARCH

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	350	360	370	380	390	1,850
Outlays	160	320	370	380	390	1,620

Federal spending for research and development (R&D) performed at universities covers both direct and overhead costs (also known as indirect costs). The major direct costs of research are wages for scientists, engineers, and technicians, and payments for materials and specialized equipment. Overhead costs allocated to federal research include research-related administrative overhead, library and student services, buildings and equipment used in common, and operations and maintenance. The National Institutes of Health accounts for roughly half of federally sponsored university research. The National Science Foundation and the Department of Defense are also major sources of federal funds.

To calculate the overhead expenses that can be allocated to federal research, universities typically take most, but not all, of their direct costs (known as modified direct costs) and apply a prenegotiated payment rate to them in each of several categories. The sum of the rates from all of these categories is the overall payment rate for overhead expenses. Overall overhead payment rates could be set and frozen for all universities at 90 percent of their current level. That option would result in savings of $160 million in 1995 and $1.6 billion over the 1995-1999 period. It would have the advantage of ensuring that no single university would experience a very large reduction, but it would hurt small and state universities that have kept their overhead costs low. To capture the savings from this option, the Congress must reduce the appropriations for university research by an amount corresponding to the mandated reduction in overhead costs.

In 1972, each dollar of direct research funding paid to universities carried an additional 30 cents to cover the overhead costs allocated to federal research. Over the next decade, the share of overhead costs rose rapidly, finally leveling off at around 45 percent beginning in 1985. By 1990, 46 cents in indirect costs were paid for each dollar spent on direct research costs. (Because payment rates are applied only to a portion of the total direct costs and because some agencies pay lower overhead rates for certain grants, the overall payment rate is higher than the ratio of overhead costs to direct costs.) Clearly, the overhead payments for federally sponsored university research have increased faster than the direct costs of research, which have themselves increased faster than the general rate of inflation in the larger economy. In 1992, the Department of Health and Human Services projected that overhead costs would continue to rise as a percentage of direct costs--reducing the number of grants federal agencies could make. In response, the Office of Management and Budget recently changed the rules governing indirect cost payments, in an attempt to simplify administration and reduce costs. The new rules permit universities to forgo detailed justifications of their administrative overhead costs in return for a small reduction in their administrative overhead rates. The rules are not expected to save many federal dollars.

Overhead payments related to facilities have led the increase in costs, contrary to the impression given by well-publicized instances of questionable charges by universities to overhead payment accounts. Those charges have not been a major factor in the long-term growth of the share of overhead costs; in fact, auditors estimate that they account for only about 1 percent of those costs. Increases in the costs of operating and maintaining facilities--utilities, repairs, and janitorial services--have been the major component of the escalation in facilities costs

in the past decade. And growth has continued even in the face of substantial drops in the price of energy. Higher costs for new buildings as a result of higher real estate prices, construction inflation, and interest costs have not been as significant.

The rise in the share of funding for federally sponsored university research that goes to pay for overhead has fostered a concern that each federal dollar spent is now producing less actual research activity. Freezing the payment rate for these costs at 90 percent of their current level is meant to allay that concern. Some might argue that competition by universities for grants should be sufficient to control the growth of overhead, and that the increases in the share of these costs are an unavoidable outcome of market forces and reflect real cost increases. The market for university research, however, tends to be concentrated among a relatively small number of universities overall, and very concentrated in specific research areas. Because only a few institutions contend for a large share of federal spending for university R&D, it may not be reasonable to assume that competition is enough to hold down overhead costs. The higher overhead rates charged by the largest private universities that are major recipients of federal support may indicate a lack of competition. (There is also some evidence that these same schools may charge much lower overhead rates on private grants.) If competition is indeed lacking, regulatory rules are an appropriate response to ensure that federal dollars are spent in the most productive way. Capping overhead payment rates would supply the discipline that the market has been unable to provide and motivate those institutions that are above the overall cap to become more efficient and cost-conscious.

Defenders of the current system contend that the increases in the overhead costs of university research are legitimate and that the nation's system of research universities will be hurt if universities are not permitted to recover the total cost of the research they conduct. Financially strapped institutions could be forced to reduce investments in new facilities, library collections, and the like. In fact, the success seen since 1985 in slowing the growth of overhead costs can be attributed in part to reduced spending on libraries. If inadequate library resources reduce the effectiveness of universities in performing their research and education missions in the future, the near-term savings gained by controlling overhead costs may not be worth the loss of future benefits to society as a whole. An alternative to freezing each university's overhead rate at 90 percent of its current level would be to place a single cap of 50 percent on the overall overhead rate of all universities. A single cap for all universities would disproportionately affect prominent research institutions, which tend to have high overhead rates. A 50 percent cap would save $106 million in outlays in 1995 and $1.1 billion over the 1995-1999 period.

University advocates make other points as well. The higher overhead rates of large private universities may not be due to a lack of cost discipline; instead, because these institutions lack state government appropriations, they may simply be more assiduous in claiming all that is rightfully theirs. Another argument made against a cap is that, because the data are lacking to determine the actual total costs of R&D, a cap could be set below the real cost-recovery point. Nevertheless, many in the research community would advocate reductions in the amount of overhead payments. However, they would apply the savings to increasing the number of research grants rather than reducing the deficit.

DOM-58 REDUCE SPENDING FOR THE HIGH PERFORMANCE COMPUTING AND COMMUNICATIONS PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	280	290	300	300	310	1,480
Outlays	110	230	280	300	310	1,230

The High Performance Computing Act of 1991 established the multiagency High Performance Computing and Communications (HPCC) program to further the development of technology for supercomputers and high-speed computer networks. The motives behind this program were both to help federal agencies perform their missions better and to promote the use of this technology throughout the U.S. economy. The multiagency effort costs a little more than $1 billion yearly. Cutting the program by 25 percent, and concentrating the reductions on research and development (R&D) for supercomputer technology, would save $110 million in 1995 and $1.2 billion over the 1995-1999 period.

The HPCC program is divided into five areas: supercomputer hardware, supercomputer software, high-speed computer networking, information infrastructure applications, and basic research and human resource development within those four areas. The proposed reduction in the program would be disproportionately concentrated in the first two categories and would affect several agencies, most notably the Advanced Research Projects Agency, the Department of Energy, the National Aeronautics and Space Administration, and the National Science Foundation. To realize savings from the reductions, the Congress would have to decrease the appropriations for the agencies by the amount of the reductions.

Focusing any reductions in the program on supercomputer R&D makes sense because the federal government's efforts to promote the commercial use of parallel supercomputer technology are running counter to the direction that the computer field is taking. HPCC planners are promoting so-called massively parallel supercomputers, which typically are composed of hundreds, even thousands, of relatively inexpensive microprocessors (similar to those that power ordinary personal computers) that are linked together and operated in parallel. Such computers are less expensive to manufacture than conventional supercomputers and have high theoretical maximum calculation speeds.

The trend in the field, however, is toward wider use of engineering workstations (high-powered technical versions of the personal computer) for the high-level mathematical analyses that for years have been the nearly exclusive domain of the supercomputer. The workstation is reducing the demand for all supercomputers, just as the personal computer reduced the demand for mainframe computers.

Opponents of the current HPCC program argue that not only are workstations preempting supercomputers generally, but clusters of workstations also have specialized software that permits them to work on the same kinds of problems that massively parallel supercomputers are capable of handling. Many universities and industry researchers have begun to use such clusters in lieu of purchasing supercomputers. Furthermore, although the HPCC parallel supercomputer technology is very fast in some applications, it has yet to demonstrate that it is as fast, as flexible, or as reliable as conventional supercomputers for most tasks. At present, parallel systems have only a small percentage of the software available to conventional supercomputers and are much more difficult to program.

In addition, opponents of the supercomputer R&D that the HPCC program is conducting note that the computer industry no longer needs super-

computers as a way of moving forward in the area of component technology (for example, microchips). If anything, as the recent National Science Foundation Panel on High-Performance Computing noted, parallel supercomputers depend on less powerful computers (like personal computers and workstations) for improvements in component technology, rather than the reverse.

Advocates of maintaining the HPCC program's focus on supercomputers contend that the research has substantial value despite its being out of step with the rest of the field. They argue that even if the specific supercomputers and related software developed under the HPCC auspices do not experience substantial commercial success, they will provide a technological foundation for other products, in particular, other high-performance computer systems. (That foundation is not so much one of electronic components, but rather one comprising both software and computer architecture--that is, the structure for putting the various components together.)

Advocates of continued research also note that some federal agencies have missions that require the use of parallel supercomputers, especially missions related to science and intelligence. These supporters argue that the importance of these missions--for example, understanding global climate change--justifies spending for such research, regardless of the technology's commercial potential. Proponents also cite the continued improvement in the performance of parallel supercomputers, relative to conventional ones, as well as their increasing share of the supercomputer market.

DOM-59 MODIFY THE SERVICE CONTRACT ACT BY ELIMINATING THE SUCCESSORSHIP PROVISION

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	200	210	210	220	220	1,060
Outlays	190	210	210	220	220	1,050

The McNamara-O'Hara Service Contract Act of 1965 sets basic labor standards for employees on government contracts whose principal purpose is to furnish labor, such as laundry, custodial, and guard services. Contractors covered by this act generally must provide these employees with wages and fringe benefits that are at least equal to those prevailing in their locality or those contained in a collective bargaining agreement of the previous contractor. The latter provision applies to successor contractors, regardless of whether their employees are covered by a collective bargaining agreement.

The cost of services procured by the federal government could be reduced by permitting successor contractors to pay lower wage rates or to provide less costly fringe benefits than those provided by their predecessors. Under this option, successor contractors would still be subject to the rules on prevailing wages and fringe benefits. This change in requirements would reduce outlays by about $190 million in 1995 and by about $1.1 billion over the 1995-1999 period, provided federal agency appropriations are reduced to reflect the anticipated reduction in costs.

Federal procurement costs would fall because this option would promote greater competition among contractors. The current rule discourages potential successors from bidding on contracts in which the existing provider has a collective bargaining agreement, unless they have similar agreements.

The provision for successor contractors is intended, however, to prevent bidders from undermining existing collective bargaining agreements. Eliminating this provision would reduce the compensation of workers in some firms that provide services to the government. Some supporters of keeping the provision argue that a reduction in compensation would, in turn, reduce the quality of such services.

DOM-60 REPEAL OR MODIFY THE DAVIS-BACON ACT

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Repeal the Davis-Bacon Act			
Budget Authority	500	510	520	540	550	2,620
Outlays	160	500	700	810	910	3,080
			Raise the Threshold to $1 Million			
Budget Authority	160	170	170	180	180	860
Outlays	40	130	180	220	240	810
			Raise the Threshold to $250,000			
Budget Authority	70	70	70	70	80	360
Outlays	20	50	70	80	90	310
			Change from Weekly to Monthly Wage Reporting			
Budget Authority	70	70	80	80	80	380
Outlays	10	50	60	70	70	260

NOTE: The conference report on the 1994 appropriation for the Department of Labor prohibits the department from implementing certain changes in the "helper" regulations during 1994. The estimates presented here are based on the assumption that this prohibition will not be extended. If it was extended, savings from either repealing the Davis-Bacon Act or raising the threshold would be greater.

Since 1935, the Davis-Bacon Act has required that "prevailing wages" be paid on all federally funded or federally assisted construction projects with contracts of $2,000 or more. The procedures for determining prevailing wages in the area of a construction project, as well as the classifications of workers who receive them, favor union wage rates in some cases.

The federal government could reduce outlays for construction by repealing the Davis-Bacon Act or by modifying it. Repealing the act would reduce outlays by about $160 million in 1995 and by about $3.1 billion over the 1995-1999 period. Raising the threshold for determining which projects are to be covered by Davis-Bacon from $2,000 to $1 million would exclude about 27 percent of the value of all contracts currently covered by the act. Savings in that case would total about $40 million in 1995 and about $810 million over the five-year period. Raising the threshold to $250,000 would exclude about 11 percent of the value of all contracts and save about $310 million over the five-year period. Changing the requirements for wage-and-hour reporting for contracts covered by Davis-Bacon from a weekly to a monthly basis would reduce compliance costs for contractors by about $260 million over the five years. Each of these estimates assumes that the Congress would reduce federal appropriations for agencies to reflect the anticipated reduction in costs.

Repealing Davis-Bacon or raising the threshold for projects that it covers would reduce the cost of federal construction. In addition, either action would probably increase the opportunities for employment that federal projects might offer to less skilled workers. Such changes would, however, lower the earnings of some construction workers. Opponents of these options also argue that eliminat-

ing or relaxing Davis-Bacon requirements could jeopardize the quality of federally funded or feder-!!y assisted construction projects. Reducing the -quirements for wage-and-hour reporting would lessen the paperwork required of employers, but at the same time it might diminish the effectiveness of the Davis-Bacon Act by reducing the government's ability to detect noncompliance.

Chapter Four

Entitlements and Other Mandatory Spending

Entitlement programs provide benefits to all who are eligible to receive aid and choose to participate. Social Security, Medicare, Medicaid, food stamps, and farm price supports are major federal entitlements. Spending on these and other so-called mandatory programs (not including deposit insurance) accounts for about one-half of all federal outlays. In 1994, this category is expected to cost $800 billion, or about 12.1 percent of gross domestic product (GDP).

Under current law, outlays for mandatory programs are expected to increase at an average annual rate of 6.5 percent between 1994 and 1999. Under the Congressional Budget Office's (CBO's) baseline assumptions, the balance of federal spending is projected to rise by an average of 1.9 percent a year during the same period and discretionary spending is estimated to increase at an annual rate of only 0.8 percent. The job of managing the growth of federal spending, therefore, will be largely a matter of controlling the growth of mandatory outlays.

Spending in entitlement programs is primarily determined by the program rules that govern eligibility, the extent of participation, benefit levels, and the cost of providing noncash benefits, not by the annual appropriation process. A variety of other factors also increase or decrease outlays for entitlements, including demographic shifts, changes in providers' practices, and rates of inflation. Entitlement spending is, therefore, only partly under the direct control of the Congress.

The total that is spent on entitlements has grown rapidly since the early 1960s. As a share of GDP, however, much of the increase had already occurred by about 1975. Steadily increasing spending for retirement and disability programs, plus the creation of Medicare and Medicaid in 1965, spurred the growth of federal entitlement outlays from less than 6 percent of GDP in the early 1960s to about 11 percent in 1975. Since then, the share of national production committed to entitlement programs has grown more slowly and is expected to be about 13 percent by 1999.

The largest force behind this continued growth in entitlement spending is the rapid rise in spending on Medicare and Medicaid. If no changes are made to any entitlement programs, federal spending on these two programs is expected to grow at an annual rate of about 11 percent between 1995 and 1999, while spending on other entitlements is expected to grow at an annual rate of about 4.2 percent during this period.

The rapid growth that is expected in entitlement spending will happen despite the reductions included in the Omnibus Budget Reconciliation Act of 1993 (OBRA-93), many of which were in CBO's *Reducing the Deficit* volume of last year. In particular, OBRA-93 adopted several of the options relating to Medicaid and Medicare. It tightened Medicaid's processes of estate recovery and the rules of financial eligibility for long-term care, eliminated the return-on-equity payments for proprietary skilled nursing facilities, reduced several components of Medicare's reimbursement rates for Supplementary Medical Insurance (SMI), and extended provisions for Medicare to act as a secondary payer for disabled beneficiaries and beneficiaries with end-stage renal disease. Nonhealth changes enacted in OBRA-93 include imposing a fee for the federal administration of states' payments that increase Supplemental Security Income benefits, restricting multiple use of the housing loan guaranty benefit, and raising the loan fee for housing loans guaran-

teed by the Department of Veterans Affairs. Finally, OBRA-93 replaced some guaranteed student loans with direct loans and established a system of auctioning licenses for the use of the radio spectrum.

Federal spending on entitlements is also influenced by the Budget Enforcement Act of 1990 (BEA), which links changes in spending on entitlements and other mandatory programs with changes in governmental receipts. Under the act, cumulative legislative changes in mandatory spending programs and federal receipts since 1990 may not increase the combined current- and budget-year deficits through 1998. Thus, an entitlement program can be increased only if another one is cut or taxes or fees are raised. Similarly, a tax can be cut only if another one is increased or if entitlement spending is reduced. This requirement, which is called pay-as-you-go, applies not to each new law individually, but to the total impact of all laws since 1990 that affect the relevant fiscal years.

This BEA rule is qualified in several ways. For instance, increases in direct spending or tax cuts for designated emergencies are exempt from the requirement. This provision has only been used once, in March 1993, to extend Emergency Unemployment Compensation benefits. In addition, the BEA excludes the receipts and mandatory outlays of the Social Security retirement and disability trust funds from all calculations under the act, including the pay-as-you-go requirements. (Social Security is subject to its own set of rules, however, which are designed to protect the balances in these trust funds.)

If the BEA rule is violated, a targeted sequestration--automatic cutbacks applying only to selected mandatory programs--must take place. But many of the major benefit programs, such as Social Security, federal employees' retirement, and most means-tested programs, are wholly exempt from the automatic cuts. In addition, other programs (including Medicare and Stafford student loans) are subject to limited cuts. These rules leave a relatively small portion of mandatory spending to bear the brunt of a large pay-as-you-go sequestration.

Program Trends and Options

In addition to suggestions for curtailing spending in specific programs, broad approaches to restraining the growth of entitlement spending have been suggested. One would place a cap on spending; another would apply a means test to restrict eligibility for benefits.

Most current proposals aimed at placing an enforceable cap on mandatory spending would tie the growth of spending for individual programs to inflation and the increase in the size of the eligible population. A transitional growth factor would be added, allowing the new policy to be phased in. Most proposals would also establish an across-the-board sequestration procedure to prevent a breach of the cap. Many advocates of this approach, however, do not accompany the call for a mandatory cap with policy proposals to achieve the reductions in individual programs that would be needed to avoid sequestration. And in many cases, such a sequester would involve large percentage cuts in benefits.

An across-the-board sequestration of mandatory programs could not be carried out easily, particularly if it were large. Government benefit checks and other mandatory spending could not simply stop flowing after the cap was reached without disrupting the lives of millions of citizens. Agencies in the executive branch could estimate the likely shortfall resulting from the cap and adjust all future payments to account for the effect of the limit, but that would involve an enormous amount of bureaucratic discretion and uncertainty about which benefits would actually be provided. In any case, the courts might be asked to respond to the conflict between the legislation that authorized the mandatory spending and a sequestration of that spending.

Applying a means test to entitlement programs has also been suggested as a broad strategy for curbing the growth in this spending. One approach would control entitlements as a group through a form of means-testing under which benefits would be cut most for beneficiaries with the highest incomes, as discussed in ENT-57. An alternative

approach would reduce the growth of entitlement spending on a program-by-program basis. New program rules could limit those who qualify for benefits or reduce the amount of benefits provided (for example, see ENT-09, ENT-23, ENT-40 and ENT-53).

As noted earlier, the major force behind rising entitlement costs is health care spending. Current proposals to restructure the health care system include the possibility of enacting some of the options described in this volume (see ENT-25 through ENT-40). This volume, however, focuses on reducing the deficit, while the Administration and others want to use funds from their proposals, including those concerning health care, to finance expansions in health insurance coverage. Thus, there is tension between different groups, some of which want to use savings from a variety of proposals to reduce the deficit, while others want to use any funds to expand coverage.

Medicare

Medicare was among the fastest growing of the major spending programs during the 1980s, outpacing defense and Social Security and second only to net interest payments. It is expected to provide $160 billion in benefits in 1994 through two related programs: the Hospital Insurance (HI) program, which covers certain costs of hospital stays and other institutional services used by elderly and disabled enrollees, and the SMI program, which primarily pays for the services of physicians and other providers of outpatient health care (see Table 7). Spending has been fueled in recent years not only by growth in the eligible population, but also by increases in the intensity and cost of medical services used by enrollees. A number of legislative changes have been made in recent years to reduce program growth.

CBO predicts that HI outlays will rise at a nominal rate of about 9.0 percent a year between 1994 and 1999 and that SMI costs will increase at a nominal rate of 12.7 percent a year. Thus, without change, Medicare will account for 24 percent of entitlement spending in 1999, compared with 20 percent in 1994. ENT-28 through ENT-33 consider a variety of options to limit payments to providers of medical services; ENT-34 through ENT-40 discuss several ways to increase beneficiaries' payments.

Medicaid

Medicaid is a joint federal and state program that provides medical assistance for certain people with low incomes. It covers participants in such income support programs as Supplemental Security Income and Aid to Families with Dependent Children (AFDC). Other people who have somewhat greater incomes and high medical expenses, and selected groups targeted by recent program expansions--such as children and pregnant women in families with low incomes--are also covered. About 70 percent of Medicaid spending goes to the aged and disabled, although they represent about one-fourth of participants. Much of this money pays for long-term care in nursing homes.

With projected federal outlays of $86 billion in 1994, more than 10 percent of entitlement spending, the size of Medicaid spending dwarfs that of other means-tested entitlement programs. Program outlays rose about 10 percent a year in the 1980s as a result of the rising costs of medical care, greater use of covered services, and growth in the size of the eligible population. Between 1989 and 1992, program growth shot up to an average annual rate of 25 percent. The unusually rapid growth was attributable to a number of factors, among them the recession, the rise of disproportionate share payments to hospitals, and states' efforts to shift programs funded with state-only dollars to the Medicaid program. The growth in Medicaid spending began to stabilize in 1993, and CBO expects that future growth will continue at more stable levels that are only slightly higher than those of the 1980s. ENT-25 through ENT-27 describe options that would control spending on Medicaid.

Table 7.
CBO Baseline Projections for Mandatory Spending, Excluding Deposit Insurance (By fiscal year, in billions of dollars)

	Actual 1993	1994	1995	1996	1997	1998	1999
Means-Tested Programs							
Medicaid	76	86	96	108	121	135	151
Food Stamps[a]	25	25	26	26	28	29	30
Supplemental Security Income	21	25	24	24	29	32	35
Family Support	16	17	18	18	19	19	20
Veterans' Pensions	4	3	3	3	3	3	3
Child Nutrition	7	7	7	8	8	9	9
Earned Income Tax Credit	9	11	15	18	20	21	22
Student Loans	2	2	2	2	1	1	2
Other	3	3	3	4	4	4	5
Total, Means-Tested Programs	162	179	195	211	233	254	276
Non-Means-Tested Programs							
Social Security	302	318	335	352	370	388	408
Medicare	143	160	177	195	215	238	264
Subtotal	445	478	512	547	585	626	672
Other Retirement and Disability							
Federal civilian[b]	39	40	42	43	46	48	51
Military	26	26	27	29	30	32	35
Other	4	5	5	5	5	5	5
Subtotal	69	71	74	77	81	85	90
Unemployment Compensation	35	27	24	25	25	26	26
Other Programs							
Veterans' benefits[c]	17	18	17	16	18	18	19
Farm price supports	16	11	7	8	8	8	9
Social services	5	6	6	6	6	6	5
Credit reform liquidating accounts	2	2	-1	-8	-4	-5	-6
Other	10	12	9	8	8	9	8
Subtotal	49	48	38	30	36	36	35
Total, Non-Means-Tested Programs	599	624	649	679	727	773	823
Total							
All Mandatory Spending, Excluding Deposit Insurance	761	803	844	890	960	1,026	1,099

SOURCE: Congressional Budget Office.

NOTE: Spending for major benefit programs shown in this table includes benefits only. Outlays for administrative costs of most benefit programs are classified as domestic discretionary spending; Medicare premium collections are classified as offsetting receipts.

a. Includes nutrition assistance to Puerto Rico.

b. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.

c. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

Other Means-Tested Entitlement Programs

In addition to Medicaid, means-tested entitlement programs include Food Stamps; SSI for the aged, blind, and disabled; family support payments (primarily AFDC); pensions for needy veterans who are aged or disabled; child nutrition (such as the School Lunch Program); and the refundable portion of the earned income tax credit (EITC). At $93 billion in 1994, expenditures on these programs represent about 12 percent of entitlement spending

In recent years, caseloads in the AFDC and Food Stamp programs have increased significantly, while real AFDC benefit levels have declined. Federal spending for the refundable portion of the EITC--a federal program that benefits low-income working families with children--rose from about $1 billion in the early 1980s to $9 billion in 1993, largely as a result of the expansions included in the Tax Reform Act of 1986 and the Omnibus Budget Reconciliation Act of 1990. Spending for the EITC is projected to increase to $11 billion in 1994 and then double to $22 billion in 1999 as a result of changes in OBRA-93 that increased benefits for families, particularly those with more than one child. ENT-25, ENT-44, and ENT-45 would reduce federal spending on certain means-tested programs by targeting benefits more narrowly and limiting federal payments for administering some of these programs.

The subsidized component of the Federal Stafford Loan Program is another means-tested entitlement. Through it students can borrow to attend post-secondary educational institutions. The annual budgetary cost of Stafford loans--as well as that of other federal loan and loan guarantee programs--consists of the present value of current and expected future subsidies for loans that originate in a specific year. Stafford loans are much less directed toward poor students than Pell grants, which form the main discretionary program providing aid to postsecondary students.

CBO's baseline projections show program costs for Stafford loans and other student loans averaging about $2 billion through 1999. These costs result from enacting a less costly direct loan program. ENT-22 and ENT-23 would reduce the federal cost of Stafford loans by reallocating part of the costs to students and their families.

Social Security and Other Retirement and Disability Programs

Social Security, the largest entitlement program, is expected to provide benefits of $318 billion to more than 42 million elderly and disabled workers and members of their families in 1994. Outlays for benefits have grown over the years as a result of the inclusion of new groups among those deemed eligible for benefits, more recipients among existing eligible groups, cost-of-living increases in benefits, and the higher real earnings--hence higher benefits--of newly retired workers. The Social Security Amendments of 1983 made major changes in the program to improve its financial standing. Although most changes involved financing and coverage, others delayed annual cost-of-living increases to recipients and made some benefits subject to taxation. The amendments also increased the age of eligibility for full retirement benefits from 65 to 67, with the change phased in during the first quarter of the next century.

Baseline projections for Social Security spending reflect the influence of the above factors on the program through 1999. The increase in the number of aged people benefitting from Social Security has slowed in recent years. Although this trend will continue for several more years, as the relatively small group of people born during the 1930s becomes eligible, it will be partially offset by the aging of the baby boomers as they move into their late 40s and early 50s, when disability incidence rates are higher.

Although the Social Security program has special rules under the BEA and is not included in the pay-as-you-go budget discipline, it nonetheless accounts for almost two-fifths of entitlement spending; cutting it would reduce the total budget deficit. Options to alter the program's benefit structure are considered in ENT-48 through ENT-51. In addition, restraint on the annual cost-of-living adjust-

ment for Social Security is a major component of ENT-56, which considers all non-means-tested retirement and disability entitlements.

Other retirement and disability programs--which will cost $71 billion in 1994, or about 9 percent of entitlement spending--are dominated by the government's civilian and military retirement programs. Spending on these programs is influenced by factors similar to those affecting Social Security, and outlays are expected to increase at like rates in CBO's baseline. ENT-56 contains options that would modify benefits for former federal workers.

Aid to Jobless Workers

Two entitlement programs that provide assistance specifically to unemployed workers are the federal/state unemployment compensation (UC) program and the much smaller federal Trade Adjustment Assistance (TAA) program. Spending on UC declined in the mid- and late 1980s but rose significantly in 1990 and 1991 because of the economic slowdown; spending increased further in 1992 and 1993 because of continued high claims and enactment of the temporary Emergency Unemployment Compensation program in November 1991. This program has been extended several times, most recently in November 1993; it is now scheduled to expire in February 1994.

CBO's baseline for the UC program projects relatively constant spending between 1994 and 1999 at around $25 billion. Although lower unemployment rates are expected to reduce the demand for UC, increases in average benefits will tend to offset that effect. UC is included in the federal budget, but state laws set most of the benefit and tax provisions in the regular state programs, which provide the vast majority of benefits. Thus, states can generally offset federal options that would reduce regular UC spending, and permanent budgetary savings cannot usually be attributed to federal changes in regular UC rules. As a result, this chapter does not include federal options limiting regular UC benefits. ENT-42 would reduce the TAA program, however.

Non-Means-Tested Veterans' Programs

Veterans' benefits constitute another category of federal entitlement spending. CBO projects that non-means-tested spending for veterans' compensation, readjustment benefits, life insurance, and housing programs will total about $18 billion in 1994, or about 2 percent of all entitlement spending during that year, with relatively slow growth projected through 1999. ENT-52 through ENT-54 would restrict federal spending on veterans' benefits by limiting eligibility for certain programs and raising costs to participants. In addition, ENT-51 would reduce Social Security disability payments for some of those who also receive veterans' compensation.

Farm Price Supports

Spending for farm price and income support programs and other mandatory programs related to agriculture is expected to be $11 billion in 1994--less than half its peak of $29.5 billion in 1986. The price and income support programs administered by the Department of Agriculture's Commodity Credit Corporation dominate this category. Reduced federal spending since 1986 reflects cuts in support rates and reductions in the amounts of land on which payments are based. Rising commodity prices also contributed to the decline in spending.

CBO's baseline for these programs projects further reductions in spending, to about $9 billion by 1999. Target prices are assumed to remain constant during this period; projected outlays decline mostly because commodity prices are expected to rise gradually. ENT-06 through ENT-09 and ENT-13 through ENT-15 consider ways to reduce federal spending by lowering outlays for commodity programs and the crop insurance program. ENT-10 through ENT-12 would lower federal spending by cutting programs that subsidize or promote exports of farm commodities.

User Fees and Other Changes in Direct Spending

Fees can be charged to users of resources, facilities, or services provided by the federal government to raise funds to help pay for them and to promote their more efficient use. Options describing improved pricing or increased fees in a variety of areas are included in this chapter (ENT-01 through ENT-05 and ENT-16 through ENT-21). For example, the federal government could index nuclear waste disposal fees for inflation or establish charges for airport takeoff and landing slots.

Receipts from fees would be treated under the Budget Enforcement Act like spending changes in entitlements or mandatory programs if the legislation changing the fees originated in an authorizing committee. In this case, the added receipts from fees would be credited to the pay-as-you-go scorecard.

In recent years, however, legislation originating in appropriations committees has changed some fees. If options in this volume were to be enacted in this way, the consequent spending reductions for the budget year would allow expenditures on discretionary programs to be raised by the same amount.

ENT-01 CHARGE MARKET PRICES FOR ELECTRICITY SOLD BY POWER MARKETING ADMINISTRATIONS

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	0	1,200	1,200	1,200	1,200	4,800

Hydroelectric power generated at 129 federally owned plants is sold by power marketing administrations (PMAs), which are agencies of the Department of Energy. In recent years these federally owned hydroelectric plants have generated about 6 percent of the electricity sold in the United States. Under current law, the PMAs must first offer to sell most of this power to rural electric cooperatives, municipal utilities, and other publicly owned utilities (collectively known as preference customers). Any excess PMA power not purchased by preference customers can be sold to investor-owned utilities. Current law requires that these sales be made at cost. This option would eliminate the requirement to offer PMA power first to preferred customers and would allow the PMAs to sell it to the highest bidder.

The federal government charges an average of about 2 cents per kilowatt-hour (kwh) for this power. PMA electricity prices vary widely among hydroelectric projects. In 1993, PMA wholesale electricity prices ranged from 3.25 cents per kwh to less than 1 cent per kwh. Determining the market value of PMA power at each of the government's hydroelectric projects would probably require auctions at which preferred customers and privately owned utilities could compete to purchase the electricity. As a preliminary estimate of the market value of PMA power, the Congressional Budget Office looked at the average price of wholesale power transactions in regions of the country served by the PMAs. The market value of this power is about 3 cents per kwh.

By eliminating the public power preference and selling the power to the highest bidder, the federal government could increase annual power receipts by about $1 billion. The additional revenues could be used by the PMAs to repay the $14 billion cost of constructing existing plants. In addition, the current practice of selling power below market rates leads to levels of electricity consumption in PMA service areas that are inconsistent with the government's energy conservation objectives. Conversely, many argue that large rate increases would adversely affect regional economies.

Proponents of reserving PMA power for use by public utilities argue that this is an appropriate use of the government's hydroelectric resources, rather than allowing private companies to profit from selling public resources. Furthermore, proponents argue that publicly owned utilities have encouraged widespread use of electricity (especially in rural areas) at low rates.

ENT-02 IMPROVE PRICING FOR COMMERCIAL AND RECREATIONAL USES OF PUBLIC LANDS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Federal Water Policy Reforms	15	15	20	30	30	110
Raise Recreation Fees at Federal Facilities	140	140	140	150	150	720

The federal government owns and manages nearly 650 million acres of land in the United States. This land is used in a wide variety of ways, including recreation and water reclamation. For most commercial and some recreational uses, the government is compensated--often by fees. In some cases, those fees may not provide the government with a fair return, and underpricing may lead to overuse. Better pricing could increase federal receipts and alleviate overuse by reducing commercial and recreational activity.

Water Sales. The Bureau of Reclamation provides water for agriculture in the Western states and also supplies municipal water systems. This water is made available through long-term contracts with water district groups that are composed of individual private users. Water prices charged under these contracts are generally much lower than the true market value of the water. In agriculture, the charges rarely cover the federal costs associated with water projects. Federal water is often provided at less than its full costs for some agricultural commodities, such as cotton, which are subject to price support programs.

In recent years, the Congress has considered several reforms aimed at increasing receipts from agricultural users of federal water and reducing subsidies to them. The Central Valley Project Improvement Act of 1992 (CVPIA) sets aside water for fish and wildlife, introduces a graduated pricing system for agricultural users of Central Valley Project (CVP) water, shortens the lengths of renewed CVP contracts, and prevents the Bureau of Reclamation from entering into new contracts until environmental goals are reached. There are, however, other opportunities for price reform that the CVPIA does not address.

One reform would allow farmers who grow agricultural commodities that are in surplus to receive only one of the federal subsidies: either crop price support payments or federally subsidized water. Another reform would require that farms of more than 960 acres be charged the full cost of federal irrigation water. (Current law contains this requirement but is often circumvented because of the vague definition of the term "farm.") These two reforms are examples of changes in the current system that could increase federal savings from farmers using federally supplied irrigation water. Under provisions of the CVPIA, California farms that receive CVP water--including a majority of farms larger than 960 acres--will pay the full cost of approximately 10 percent of their water. Federal receipts from water sales to these farms could increase if full-cost charges were applied to the remainder of their water allocations. Taken together, these reforms could increase receipts by at least $90 million over the 1995-1999 period. Commodity program payments could decrease by $20 million over the same period, for total savings of $110 million over five years.

Recreation Fees. All federal agencies that hold major tracts of land allow recreational access and provide some visitor services. The services range from maintaining rough hiking trails to operating fully developed recreational facilities, such as campsites and marinas. Entrance and user fees are charged at some locations. These charges were

increased in 1993 and the Congress approved new and expanded fees for 1994, but they will still cover only a small portion of the direct service costs. For example, in 1994, the National Park Service will spend an estimated $230 million on visitor services and will recover less than $90 million in fees. Requiring land management agencies to charge fees to cover these direct costs would shift the cost burden to the beneficiaries of the services and would improve pricing of public land use. Such fees would lower net federal costs by $140 million in 1995 and by $720 million over five years.

Arguments against additional increases in fees reflect the view that the national parks and public lands are a vital and accessible part of our national heritage. The social benefits of visits to the parks--especially for the elderly and the poor--far exceed the government costs. Visits should be encouraged, not discouraged by increasing fees.

With additional increases, however, taxpayers would not have to bear the costs of police protection and other services that benefit only the users. The overcrowding that is now a problem at many parks could be alleviated by an appropriate fee structure. And visits by the poor and the elderly could be encouraged by free-access days or the cross-subsidization of urban parks, by which fees collected at some parks would be used to offset the costs of maintaining others that have lower charges or none at all.

ENT-03 CHANGE REVENUE-SHARING FORMULA FROM A GROSS-RECEIPT TO A NET-RECEIPT BASIS FOR COMMERCIAL ACTIVITIES ON FEDERAL LANDS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	170	180	180	190	200	920
Outlays	130	180	180	190	200	880

The federal government owns nearly 650 million acres of public lands--nearly one-third of the U.S. land mass. These public lands contain a rich supply of renewable and nonrenewable natural resources: timber, coal, forage for livestock, oil and natural gas, and many nonfuel minerals. Private interests are given access to much of the federal land to develop its resources. Generally, private parties pay fees to the federal government based on the commercial returns realized. In many cases, the federal government allots a percentage of those receipts to the states and counties containing the resources, as compensation for tax revenues they did not receive from the federal lands within their boundaries.

The federal government typically calculates the allotments to states and counties on a gross-receipt basis before taking account of its program costs. This practice has an important disadvantage: providing federal receipts-sharing on a gross rather than a net basis sometimes causes the federal government's program costs to exceed its share of receipts.

In most cases, the U.S. Forest Service is required to allot 25 percent of its gross receipts from commercial activities in the national forests to the respective states and counties. The Department of the Interior allots 4 percent of its timber receipts, an average of 18 percent of its grazing fees, and 4 percent of its mining fees from "common variety" materials to the states; the Department of the Interior, specifically the Minerals Management Service (MMS), allots 50 percent of its adjusted onshore oil, gas, and other mineral receipts to the states. (The MMS deducts 50 percent of its administrative costs from the gross-receipt calculation before distributing those payments. In effect, the states share 25 percent of the burden of these administrative costs.) On certain federal lands--specifically national forests affected by spotted owl protections and the Oregon and California grant lands--payments to states and counties are made on the basis of an average of payments made in the past.

Federal savings would be substantial if the Congress required these agencies to deduct their full program costs from their gross receipts before paying the states. The regional jurisdictions would continue to receive the same allotted percentage of net federal receipts and would accrue receipt shares totaling about $600 million in 1995.

Certain federal costs could increase, however, under the federal Payment in Lieu of Taxes (PILT) program, which was established in 1976 to offset the effects of nontaxable federal lands on the budgets of local governments. These PILT payments to the states are partially reduced by the amount of revenue-sharing payments from federal agencies. Payments under the PILT program would increase if net program receipts were shared and the Congress appropriated such an increase. These additional payments have been netted out of the projected savings. Changing the revenue-sharing formula from a gross-receipt to a net-receipt basis would reduce net federal outlays by $880 billion over the 1995-1999 period.

Changing the revenue-sharing formula to a net-receipt basis would, in all probability, have a negative impact on the economies of the respective states and counties. A significant source of revenue for some states and counties would be reduced. That reduction in revenues might lead to serious cuts in state and county spending. To help alleviate that hardship, the federal agencies could switch gradually to the net-receipt basis over a period of several years.

ENT-04 INDEX NUCLEAR WASTE DISPOSAL FEES FOR INFLATION

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	15	35	50	70	85	255

Electric utilities pay one mill (one-tenth of a cent) into the Nuclear Waste Fund for each kilowatt-hour of electricity sold from a nuclear power plant. The fund finances the development of storage and permanent disposal facilities for high-level radioactive wastes; the first permanent repository is projected to open in 2010. The fee has remained constant since its inception in 1983, although the price level (measured by the gross domestic product deflator) has risen over 40 percent since then. Based on current CBO projections, indexing the fee for inflation would raise $255 million over five years.

The primary arguments in favor of this proposal are that the current fee may be insufficient to finance the necessary disposal facilities, especially because inflation has eroded its value; and that indexing equitably allocates the costs between present and future operators of nuclear power plants. A June 1990 study by the General Accounting Office argued that historically plausible inflation and real interest rates (4 percent and 3 percent, respectively) could produce a present-value shortfall of $2.4 billion in 1988 dollars--roughly 10 percent of total system costs--if the fee remains fixed.

Against automatic indexing, the Energy Department argued in a November 1990 report that its revenue estimates show the fund roughly in balance; that given present levels of uncertainty, the fund may in fact be collecting too much money; and that occasional "step" adjustments in the fee, introduced as new information is acquired, would be a better way to avoid problems of under- or overfunding.

ENT-05 CHARGE ROYALTIES FOR HARDROCK MINING ON FEDERAL LANDS

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	0	70	70	70	70	280

The General Mining Law of 1872 governs access to hardrock minerals---gold, silver, uranium, copper, molybdenum, and most other metals--within the boundaries of public lands. For fiscal years 1994 through 1998, any holder of more than 10 unpatented mining claims must pay a maintenance fee of $100 a claim. In addition, all claimholders must pay a $25 location fee when recording a location notice for an unpatented claim. For fiscal years 1999 and beyond, a claimant does not have to pay a holding fee but must spend at least $100 a year on development for each claim. Currently, the federal government collects no royalties for the production of hardrock minerals on federal lands.

Once minerals are determined to be economically recoverable, the claimholder may apply to buy (patent) the claim by paying the federal government $2.50 or $5 per acre, depending on the type of claim, plus a small application fee.

Legislation to reform the Mining Law of 1872 has been introduced in the Congress for at least the last three sessions. Most recently, in the 103rd Congress, the House of Representatives approved H.R. 322. The Senate had already approved a mining reform bill--S. 775. Both are aimed at reforming the hardrock mining system to bring it into line with the leasing system currently used for exploring and developing oil and gas on federal lands. Under the proposed laws, mining operators on public lands would have to share the profits of mineral production with the federal government by paying a royalty based on the value of minerals produced. In addition, the House proposal contains a moratorium on patenting, thus thwarting mining operators who try to escape royalties by buying the land.

Estimates place the value of hardrock mining production on federal lands at more than $1.2 billion a year, if new patents continue to be issued. CBO estimates that an 8 percent royalty would yield additional receipts to the federal treasury of $70 million a year, beginning in fiscal year 1996.

It is difficult to estimate royalty receipts because it is uncertain how the imposition of fees would affect hardrock mining on federal lands. In order to prepare these estimates, CBO assumes that some claims would be relinquished and some production on federal lands would be cut back, at least in the short run.

Those in favor of mining law reform--primarily the environmental community--argue that because the current fees for maintaining a claim on public land are nominal, too much land is tied up in mining. They say that although the principle of free access may have been effective in encouraging the settlement of the West and the production of vital minerals, free access is no longer necessary to ensure development. Also, they argue that royalties will compensate the federal government for the use of public lands and for extraction of minerals from them.

Proponents of mining reform further argue that charging a price for the use of federal lands and their resources will encourage the mining industry to focus on those lands most likely to yield profitable returns. This will free land for other public purposes, such as recreation and wilderness conservation. In addition, a portion of the receipts from royalties could be dedicated to the reclamation of land after mining has been completed.

Opponents of mining law reform--primarily the mining industry--argue that in the absence of free access, exploration for hardrock minerals, particularly by small miners, would decline. They also argue that royalties, by increasing costs to an industry that is already operating close to the margin of profitability, would lower development of minerals and adversely affect regional economies. Since many mineral prices are determined on a world market, mining operators would be unable to pass along most of the royalty and holding fee costs to consumers. Thus, some mines would shut down and set off ripple effects throughout their regions.

Finally, those who are opposed to reform contend that developing a system to collect fees and monitor mining activities more closely would be expensive to administer.

ENT-06 REDUCE DEFICIENCY PAYMENTS TO FARMERS PARTICIPATING IN USDA COMMODITY PROGRAMS BY LOWERING TARGET PRICES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	400	1,250	2,200	3,150	4,050	11,050
Outlays	400	1,250	2,200	3,150	4,050	11,050

Farmers who participate in federal commodity programs--those who produce corn and other feed grains, wheat, rice, or cotton--receive a deficiency payment, which is the primary form of direct government subsidy to growers. The size of the deficiency payment is calculated in part from the difference between the market price of a crop and a target price. (Table 8 shows the target prices set by current law through the 1995 crop year. The Congressional Budget Office baseline assumes that target prices are maintained at these levels for the 1996-1998 crop years.)

Budgetary savings could be achieved by reducing target prices in the years after 1994. The greater the rate of reduction, the greater would be the savings. One alternative would be to reduce target prices by 3 percent per year starting with the 1995 crops (see Table 5). Outlay savings would be an estimated $11 billion over the 1995-1999 period.

An advantage of reducing target prices is that such a reduction would increase the degree to which farmers respond to market prices, rather than to government program benefits, in making their production decisions. Market prices are better guides to efficient resource use than government program benefits.

Lower target prices would reduce farm income by reducing direct government payments. Farm income would not fall as much as government outlays because some farmers would choose not to participate in the commodity programs. Although these farmers would give up all of their government payments, they would not be required to idle part of their acreage and thus would generate income from additional production. And if grain production increases, livestock producers might benefit from lower feed costs.

Despite an improved outlook for agricultural markets, many farmers are still facing financial difficulties. In some cases, financial problems were heightened by droughts or floods in recent years. Further reductions in target prices would intensify these difficulties.

Table 8.
Target Crop Prices Under CBO Baseline Assumptions and Under 3 Percent Annual Reductions (By crop year)

	1994	1995	1996	1997	1998	1999
			CBO Baseline Assumptions			
Wheat	4.00	4.00	4.00	4.00	4.00	4.00
Corn	2.75	2.75	2.75	2.75	2.75	2.75
Rice	10.71	10.71	10.71	10.71	10.71	10.71
Cotton	0.729	0.729	0.729	0.729	0.729	0.729
			3 Percent Annual Reductions			
Wheat	4.00	3.88	3.76	3.65	3.54	3.43
Corn	2.75	2.67	2.59	2.51	2.43	2.36
Rice	10.71	10.39	10.08	9.77	9.48	9.20
Cotton	0.729	0.707	0.686	0.665	0.645	0.626

SOURCE: Congressional Budget Office.

NOTE: Wheat and corn in dollars per bushel; rice in dollars per hundredweight; cotton in dollars per pound.

ENT-07 ELIMINATE THE 0/92 AND 50/92 PROGRAMS FOR PARTICIPANTS IN USDA COMMODITY PROGRAMS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	100	230	300	340	370	1,340
Outlays	100	230	300	340	370	1,340

Current law allows participants in U.S. Department of Agriculture (USDA) price and income support programs to receive 85 percent of their deficiency payments, even though they may plant as little as 50 percent of their eligible acreage in the program crop (the 50/85 program available to cotton and rice producers), or even though they do not plant any of the program crop (the 0/85 program available for wheat and feed grain producers). Recent legislation reduced the payment to 85 percent from 92 percent. Participants who are prevented from planting by natural conditions can still receive 92 percent of their deficiency payments--the same as allowed during earlier crop years. Producers must leave the land idle or, under certain conditions, may plant minor oilseeds such as sunflower, flaxseed, and canola. This option would eliminate these programs. Producers would have to plant the program crop to receive deficiency payments. In the 1992 crop year, about 10 million acres that went unplanted in the program crops received payments under the 0/92 or 50/92 programs.

Eliminating these programs would save $1.34 billion over the 1995-1999 period. This estimate assumes that the Secretary of Agriculture would increase the acreage reduction program requirement for each supported crop if it was anticipated that eliminating the 0/92 and 50/92 programs would increase plantings. Participation in the acreage reduction program, under which producers agree not to plant a portion of their eligible land in the supported crop, is voluntary and unpaid. Producers must participate, however, to receive deficiency payments and other program benefits.

Eliminating these programs (and maintaining production at a given level by increasing the acreage reduction programs) would in effect substitute unpaid acreage reduction for paid acreage reduction. The Secretary of Agriculture has considerable discretion to increase unpaid acreage reduction requirements under the current outlook for program commodities, and proponents of this option would argue that there is no need to pay farmers to cut acreage. The 0/92 and 50/92 programs were introduced at a time when unpaid acreage reduction requirements were high, and the Secretary had little discretion to increase them.

Those who are against eliminating these programs would argue that such a move would constitute "recoupling" program benefits with planting decisions, encouraging farmers to plant some land that might better be left idle from the perspective of market returns alone. Others would point out that these programs are a safety net for farmers who cannot plant their program crops because of poor weather conditions during planting time. Sign-up periods for the 0/92 and 50/92 programs extend well past normal planting times. Other forms of disaster assistance may be more appropriate in these cases, however.

ENT-08 RAISE THE PROPORTION OF EACH FARMER'S BASE ACREAGE INELIGIBLE FOR DEFICIENCY PAYMENTS FROM 15 PERCENT TO 25 PERCENT

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	360	790	880	930	980	3,940
Outlays	360	790	880	930	980	3,940

Outlays of the Commodity Credit Corporation could be reduced by cutting the number of acres eligible for deficiency payments. This option could save $360 million in 1995 and $3.9 billion in the 1995-1999 period.

Currently, wheat, feed grains, cotton, and rice producers who participate in commodity programs receive a deficiency payment. The size of the deficiency payment is generally equal to the difference between the target price for the commodity and its market price times the program yield assigned to the farm, times "payment acres." Payment acres equal 85 percent of the farm's crop acreage base, less land idled to comply with the acreage reduction program that is in effect for the crop during that crop year.

This option would expand the changes made in the Omnibus Budget Reconciliation Act of 1990 by decreasing the amount of land eligible to receive deficiency payments from 85 percent to 75 percent of base acreage. Producers would be permitted to plant any program crop or oilseed on this additional unpaid acreage without losing eligibility for future program benefits. These changes would be introduced to reduce program spending and to increase the flexibility that farmers have in making planting decisions in response to the needs of the market rather than the rules of the farm programs.

A disadvantage of this option is that it would decrease farm income for most participants in commodity programs and for people raising crops that do not directly receive federal support. Program participants would shift some production away from program crops on land no longer earning subsidies and toward alternative crops. As a result of these changing production patterns, the incomes of growers of nonprogram crops would be hurt by the new competition.

ENT-09 RESTRICT ELIGIBILITY FOR BENEFITS FROM PRICE SUPPORT PROGRAMS AND REDUCE THE PAYMENT LIMITATION

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Limit Payments to $50,000 per Person						
Budget Authority	60	140	150	160	160	670
Outlays	60	140	150	160	160	670
Limit Payments to $40,000 per Person						
Budget Authority	120	260	290	300	310	1,280
Outlays	120	260	290	300	310	1,280
Disqualify People Whose Adjusted Gross Income Exceeds $100,000						
Budget Authority	30	60	70	70	70	300
Outlays	30	60	70	70	70	300
Disqualify People Whose Gross Revenue from Commodity Sales Exceeds $500,000						
Budget Authority	60	140	150	160	160	670
Outlays	60	140	150	160	160	670

Current law limits participants in crop price support programs to no more than $100,000 in deficiency payment benefits from the Commodity Credit Corporation during any crop year. The maximum in deficiency payments that can be received is $50,000 for an individual, plus $25,000 for a shareholder in a maximum of two corporate farms (each of which is entitled to a maximum payment of $50,000). The maximum of $100,000 can be achieved only by people who are actively engaged in the operations of relatively large farms and who have organized their farm businesses to maximize government payments.

Government costs could be reduced by allowing each farm operator to receive only the individual payment and eliminating the two corporate farm payments. This option would reduce spending by an estimated $670 million during the 1995-1999 period. Outlays could be cut further by reducing the maximum direct payment from $50,000 to $40,000, with estimated savings totaling $1.28 billion over the 1995-1999 period.

Eligibility for payments could also be limited on the basis of income or gross sales. Disqualifying people with adjusted gross income from all sources over $100,000 would save an estimated $300 million over the five-year period. Disqualifying people with gross revenues from commodity sales over $500,000 would save an estimated $670 million over the period.

Support for these changes is based on the belief that current payment limits are too high. If reductions in program spending are required, they should come from relatively large farming operations rather than relatively small ones. In addition, reducing the

limit on direct government payments would reduce their influence on the production decisions of operators of large farms, causing them to be more responsive to market returns. Operators of smaller farms, who are more likely to need government assistance, would continue to receive program benefits.

This change could harm relatively efficient-sized farm operations. In addition, until operating and price subsidies are reduced for producers in foreign countries, increasing the exposure of the most efficient U.S. farmers to market forces could hurt long-term prospects for the farm sector. Finally, the ability of farmers to reorganize their holdings to avoid the payment limitations increases the uncertainty of the estimated budgetary savings as well as the effect on farmers.

ENT-10 REDUCE LOAN GUARANTEES MADE UNDER THE USDA'S EXPORT CREDIT PROGRAMS AND ELIMINATE LOANS TO HIGH-RISK BORROWERS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	-660	470	440	440	450	1,140
Outlays	-660	470	440	440	450	1,140

The U.S. government guarantees short- and intermediate-term loans made by commercial banks to finance foreign purchases of U.S. agricultural commodities and products. Legislation requires that a minimum of $5.5 billion in loan guarantees be made annually, although actual levels of guarantees have been lower. There is no limit on the total amount of guarantees, but there is a requirement that borrowers be creditworthy. The purpose of these programs is to encourage exports of U.S. goods. Credit terms, in addition to price, are an important element of competition in world markets.

When a foreign buyer misses a loan payment, the bank making the original loan submits a claim to the U.S. Department of Agriculture. The USDA reimburses the bank, takes over the loan, and attempts collection. The U.S. government guarantees 98 percent of the principal of the loan, except loans to the former Soviet Union. In these loans, the government has guaranteed 100 percent of the principal.

This option would limit annual guarantees to $3.6 billion--about $1 billion less than assumed in the baseline. The estimate of savings assumes that the entire reduction would derive from lowering the value of loan guarantees for sales to the former Soviet Union, which is now considered to be the world's most risky borrower receiving guarantees. (In 1993, Russia became ineligible for additional credit guarantees when it failed to meet obligations on outstanding debts. In September 1993, the United States and Russia agreed to reschedule payments that were due in 1993. If the new deadlines are met and other payments are made on schedule, Russia would be eligible for new credit guarantees in 1994.) This change would reduce outlays by more than $1.1 billion over the 1995-1999 period.

Proponents of reducing guarantees of credit would argue that they are overused and potentially extremely costly. The benefits of the first several billion dollars in guarantees--in terms of export promotion--may be substantial, but the net benefit diminishes, particularly since the additional guarantees are extended to countries that are at high risk of default.

Opponents of reducing credit guarantees argue that they are vital in retaining the U.S. share of competitive world markets. Opponents also argue that these guarantees are an important part of necessary aid to the republics of the former Soviet Union; the CBO baseline assumes that they receive $1.2 billion in guaranteed credit during 1995. (Some supporters of more aid to these states, however, would prefer that they be given grain, rather than sold it with money loaned at high risk of default.) In addition, some wheat and corn producers believe that total exports and the prices that they receive for their crops would be substantially lower without these credits.

ENT-11 ELIMINATE THE EXPORT ENHANCEMENT PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	390	950	940	940	940	4,160
Outlays	390	950	940	940	940	4,160

The U.S. Department of Agriculture (USDA) subsidizes the export of agricultural commodities through the Export Enhancement Program (EEP). U.S. exporters participating in the EEP negotiate directly with buyers in a targeted country, then submit bids to the USDA for cash bonuses. The bids include the sale price, tentatively agreed to with the buyer, and the amount of the subsidy or bonus requested by the exporter.

Since its inception in 1985, $5.8 billion in EEP bonus payments have been made, mostly to assist wheat exports. The CBO baseline assumes that $5 billion in additional subsidy payments will be made during the 1995-1999 period. Eliminating the program would save nearly $4.2 billion during this period.

On the one hand, the EEP (which the United States uses to compete with the subsidy programs of other countries) may help to increase U.S. exports or maintain market share. On the other, it is not clear how effective the program has been in this regard. Moreover, some critics argue that the EEP has depressed world commodity prices, thereby penalizing competitors who do not subsidize their exports. In addition, if provisions recently negotiated under the Uruguay Round of the General Agreement on Tariffs and Trade were enacted, they would limit the use of the program in the future.

ENT-12 ELIMINATE THE MARKET PROMOTION PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	60	110	110	110	110	500
Outlays	60	110	110	110	110	500

The Market Promotion Program (MPP) was authorized under the 1990 Food, Agriculture, Conservation, and Trade Act to assist U.S. agricultural exporters, particularly when they face unfair trading practices abroad. Payments are made to offset partially the costs of market building and commodity promotion undertaken by state-related, private nonprofit, and private profit-making firms. The MPP continues the Targeted Export Program, which was aimed mainly at specialty crops such as fruits and nuts, but has also targeted wine, plywood, tobacco, feed grains, meat, eggs, and several other agricultural products for promotion. The current Congressional Budget Office baseline assumes that $110 million would be obligated annually for the program in the 1995-1999 period. Eliminating this program would reduce outlays by $500 million over the next five years.

An argument for eliminating MPP funding is that the assisted groups benefit directly from the market development activities and thus should bear the full costs. The practice of subsidizing brand-name advertising by private firms in particular has come under fire. In addition, marketing funds are provided through other Department of Agriculture activities, such as the Cooperator Program of the Foreign Agricultural Service. Activities promoting exports of nonagricultural goods do not receive similar support. Therefore, why should agribusiness be singled out for this type of federal aid?

Eliminating the MPP could place U.S. exporters at a disadvantage in international markets. Those concerned about U.S. exports of high-valued agricultural products consider the program a useful tool for developing markets for these products.

ENT-13 REDUCE COSTS FOR THE DAIRY PRICE SUPPORT PROGRAM BY INCREASING PRODUCER CONTRIBUTIONS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	60	190	280	340	330	1,200
Outlays	60	190	280	340	330	1,200

The incomes of dairy producers are protected and increased through the purchase of storable dairy products by the U.S. Department of Agriculture's (USDA's) dairy price support program. Their incomes are further supported by marketing orders, which set minimum prices for milk designated for various uses. The dairy industry is also protected from foreign competition by quotas on imports of dairy products.

Consumers may benefit because the dairy price support program helps to stabilize prices of milk and milk products. Some needy families, schools, and other institutions gain through the free distribution of dairy products that are purchased by the USDA. The program raises the prices of dairy products, however, and thus consumer costs, above the levels they would reach without government intervention.

One method of reducing the costs of dairy programs would be to increase the assessments levied on dairy farmers' production. During calendar year 1991, farmers were assessed $0.05 per hundredweight. By law, this assessment rose to $0.1125 per hundredweight in January 1992. Increasing assessments to $0.25 per hundredweight starting in January 1995 would save an estimated $1.2 billion over the 1995-1999 period.

This method of reducing dairy program costs would be straightforward and relatively easy to administer. Many dairy producers favor this approach to cutting program costs over such alternatives as reductions in federal price supports. A cut in the price support level for milk would cause a drop in the price that both consumers and the government pay for milk and milk products. Government purchases account for a relatively small portion of the total dairy market. Thus, in order to generate a significant amount of savings, the price cut would have to be relatively large. By contrast, an assessment would apply to the marketing of all milk. Therefore, a relatively small assessment would generate significant savings. As a result, the income of dairy farmers would be reduced less by the assessment than by a cut in support prices generating similar budgetary savings.

Raising these assessments, however, would reduce the net incomes of dairy farmers. Furthermore, the dairy industry would be paying part of the costs of federal government purchases of dairy products, much of which are used in domestic food assistance programs. Some would argue that this assistance should be paid for by the taxpayer rather than the dairy industry.

ENT-14 END THE FEDERAL CROP INSURANCE PROGRAM AND REPLACE IT WITH STANDING AUTHORITY FOR DISASTER ASSISTANCE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	750	360	340	310	320	2,080
Outlays	270	380	360	330	320	1,660

The federal government has offered crop insurance through the Federal Crop Insurance Corporation (FCIC) to farmers for many years to protect them against losses caused by natural disasters. This insurance is heavily subsidized. The government pays all administrative costs, subsidizes farmers' premium payments, and covers losses in excess of premiums. Even with this program in place, the government in recent years has reacted to crop shortfalls caused by drought and other natural factors by providing cash or in-kind disaster assistance. The Congress has enacted legislation providing such assistance in most years since 1986.

Participation in the federal crop insurance program has grown in the past few years, but it still covers less than half of the nation's eligible acres. Consistently low participation rates have, in part, encouraged enactment of the laws providing disaster assistance because so many farmers had no other protection. Some farmers may not have participated in the insurance program because they believed they would be covered by disaster assistance. And in fact, outlays for disaster assistance exceeded indemnity payments under the crop insurance program during the 1980s. Between 1981 and 1991, the federal government paid $8.6 billion for ad hoc disaster assistance and $2.6 billion for FCIC net indemnity payments.

This option would end federally subsidized crop insurance offered through the FCIC and replace it with federal disaster assistance, thereby saving $1.66 billion over the 1995-1999 period. Under this program, the Commodity Credit Corporation would make disaster payments to producers operating in counties with actual average harvested yields below 65 percent of the county's normal yield. Once a county was declared eligible, individual farmers would receive disaster payments for any shortfall in their own harvested yield below 60 percent of that county's normal yield.

Such a program structure would reduce expected federal outlays, compared with the current crop insurance program, primarily because it would provide benefits only in the case of substantial losses, and then only if the county, rather than just the individual, suffered significant losses as well. The program could be designed to save more or less with stricter or more lenient eligibility rules. A disadvantage of this option is that individual producers who use the current crop insurance program to control the risks they face in farming would no longer have that option.

The figures in the table contain both mandatory spending and discretionary savings. The crop insurance fund, which makes payments to satisfy farmers' crop loss claims, is categorized as mandatory spending. The administrative expenses of the crop insurance program are categorized as discretionary spending because they are controlled by annual appropriations.

The estimates of savings under this option assume that the crop insurance program ends with the 1994 crops. Savings from eliminating the crop insurance program are partly offset by the cost of disaster assistance, which is estimated at $300 million per crop year.

ENT-15 REFORM MILK MARKETING ORDERS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	90	190	230	190	100	800
Outlays	90	190	230	190	100	800

Minimum prices paid by processors and handlers for most milk produced in the United States are regulated by federal milk marketing orders that evolved from legislation first enacted in the 1930s. The intended effect of these regulated prices is to increase returns to dairy farmers and stabilize supplies and prices of milk for fluid use.

The milk marketing orders and the milk price support program of the Department of Agriculture (USDA) are interrelated. The price support program provides a floor for prices of manufacturing-grade milk by buying milk products (cheese, butter, and nonfat dry milk) if their prices fall below specified support levels. Marketing orders set minimum prices that must be paid for milk for fluid use, based on the manufacturing-grade price plus differentials that are unique to each of the nearly 40 regional orders.

This option would eliminate these pricing regulations. The average price received by dairy farmers would decline as a result, reducing their incomes and causing shifts in the pattern of production and processing throughout the country.

Proponents of deregulating the prices of milk claim that original rationales for regulating prices--apart from increasing producers' incomes--no longer justify federal intervention in the market for milk. The regulations were introduced when long-distance transportation of milk was prohibitively expensive. At that time, moving milk from one area to dampen price swings in other areas was often impossible. Local production, even in areas where production costs are high, is encouraged by the classified pricing system to ensure adequate supplies at reasonable prices.

Conditions have changed since the government introduced marketing orders. Now, with improvements in road systems and refrigerated transportation and changes in production technologies and consumption patterns, many analysts believe that regulated markets are no longer needed. Furthermore, using technology to reconstitute fluid milk--now discouraged by the regulated pricing system--would cut transport costs dramatically. Production would locate in the more efficient areas. This would lower milk prices for consumers. Greater variation in consumer prices might result, although fluid milk makes up a much smaller proportion of the food budget now than in the past. And benefits originally attributed to more stable prices would be less than at the time these regulated prices were first imposed.

This option would leave intact the USDA's milk price support program but would reduce its outlays by about $800 million over the 1995-1999 period. Spending would fall because eliminating pricing regulations would cut average prices received by farmers, which would discourage milk production and reduce government purchases of dairy products. USDA's price support program would continue to protect incomes of dairy producers, but at lower levels than under current law.

ENT-16 INCREASE FCC USER FEES

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	105	110	115	120	125	575

Increasing the level of fees charged by the Federal Communications Commission to holders of FCC licenses could increase receipts by $105 million in 1995 and by $575 million for 1995 through 1999. The Congress passed legislation in the Omnibus Budget Reconciliation Act of 1993 that established new fees for certain types of licenses and increased fees on others. These increases are expected to raise approximately $60 million in 1994 and $95 million in 1995. The fees, however, are earmarked for specific regulatory costs and do not cover all regulatory activities or agency overhead.

Those who favor increasing licensing fees argue that the fees would cover the full cost of the services that the FCC provides to license holders. These services include regulation, enforcement, rulemaking, and international and informational activities. A recent legislative proposal would set the level of fees on the basis of the equivalent of full-time employees rendering service. The level would be adjusted for such factors as coverage of license holders' service areas and whether a license provides for shared or exclusive use. Fees could be set high enough to equal the funds appropriated for FCC activities.

Those who argue against increasing FCC fees hold that such increases would drive marginal operators out of business. Low-power AM radio stations, for example, often maintain very small profit margins. A significant increase in the license fee of such a small operator could be sufficient to force the station to close. This difficulty could be overcome by linking fee increases to station coverage area or broadcast power. Moreover, this problem is less significant to license holders outside the broadcasting industry.

ENT-17 CHARGE A USER FEE ON COMMODITY FUTURES AND OPTIONS CONTRACT TRANSACTIONS

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	45	60	65	70	70	310

The Commodity Futures Trading Commission (CFTC) administers the amended Commodity Exchange Act of 1936. The purpose of the CFTC is to allow markets to operate more efficiently by ensuring the integrity of futures markets and protecting participants against abusive and fraudulent trade practices. A fee on transactions overseen by the CFTC could cover the agency's costs of operation. Such a fee would be similar to one now imposed on securities exchanges to cover the cost of the Securities and Exchange Commission (SEC).

The Administration's budget for 1994 proposed a transactions fee, set at 14 cents per "round turn transaction." Such a fee, if imposed in 1995, could generate revenues of $310 million over the 1995-1999 period, which should be sufficient to cover the CFTC's operating expenses during that period. As proposed, the legislation to establish the fee would require the exchanges to remit it four times a year, based on trading volume during the previous quarter. The CFTC would collect the fee and deposit it as an offsetting receipt to the general fund of the Treasury.

The main arguments in favor of the fee are based on the principle that users of government services should pay for those services. Those engaging in transactions that the CFTC regulates are seen as the primary beneficiaries of the agency's operations and therefore users who should pay a fee. Furthermore, the principle of charging such a fee has already been established by the SEC. Considerations of equity and fairness suggest that not charging a comparable fee to support CFTC operations could give futures traders an unfair advantage over securities traders.

Those who argue against the fee say that such charges tend to generate evasion on the part of people who would be subject to them. Users might try to avoid fees by limiting or shifting transactions to activities that are exempt from charges, which could conceivably cause market participants to desert U.S. exchanges for foreign ones. The effect of such actions could substantially lower the revenue from the fee and, of more concern, lower the benefits that futures transactions provide to the economy.

ENT-18 GRANT THE GOVERNMENT AN OPTION TO BUY SHARES OF DEPOSITORY INSTITUTIONS THAT CONVERT FROM MUTUAL TO STOCK FORM

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	65	65	60	60	60	310

When a mutual savings bank or savings and loan converts to a corporation that issues stock, initial recipients of the stock obtain claims to the existing equity in the institution. Subsequently, they reap a windfall as a result of the stock's price appreciation. Over the past two years, a record number of mutual institutions have taken advantage of favorable stock market conditions by going public and converting their embedded value into windfall gains for buyers of the stock. Typically, stock prices have risen by an average of 30 percent after the offering. Management has been the major beneficiary of these gains. An argument can be made that the federal government, by promising to protect insured depositors, has helped create this embedded value and that the deposit insurance funds should therefore also benefit from the conversion of thrifts from mutual to stock ownership.

In recent conversions, an average of 13 percent of offerings were given to directors and corporate officers in the form of free stock and stock discounts. This 13 percent does not include the generous salary increases and retirement plans that usually accompany these transactions. The government could be granted an option to buy a similar percentage, perhaps up to 15 percent, of mutual conversion stock at the offering price. The exercise of such an option for thrifts converting from mutual to stock ownership would have made the government about $60 million richer during the first three quarters of 1993. Assuming that the average volume and price appreciation of stock offerings that prevailed from the beginning of 1992 through the third quarter of 1993 will continue, the government could expect to gain about $65 million a year by exercising such an option. This option would require a moratorium on all merger conversions (a form of conversion that bypasses these stock offerings), with the exception of assisted transactions. The Office of Thrift Supervision recently placed such a moratorium on thrifts it oversees.

Depositors and managers, however, may say that they are the rightful owners of any proceeds from conversion; depositors because they "own" the mutual, and managers because they helped create the surplus. Moreover, it may be viewed as unfair to assess these institutions more than other institutions that also have gains attributable to deposit insurance. Conversions are desirable because they raise additional capital and subject institutions to greater market discipline. By reducing the windfall to depositors and managers, this option could diminish incentives for thrifts to convert from mutual to stock ownership, thus reducing the number and value of conversions that otherwise would have occurred.

Under this proposal, the proceeds that the government makes from exercising its option would be deposited into the Bank Insurance Fund (BIF) or Savings Association Insurance Fund (SAIF), depending upon which insurance fund covered the converting institution. The SAIF is far from being adequately capitalized and would benefit from any such conversion. The BIF is expected to reach its statutory capital goals in 1997. As a result, conversion proceeds from BIF-insured institutions would simply reduce insurance premium rates and would not result in additional baseline savings for 1997 and beyond. Savings from this option would not be counted in meeting the requirements of the Budget Enforcement Act (BEA) because the funding to meet current deposit insurance commitments is excluded from those requirements. Under BEA scoring rules, if the savings were used for other purposes, they would not be counted toward reducing the budget because they would represent the proceeds from asset sales.

ENT-19 ESTABLISH CHARGES FOR AIRPORT TAKEOFF AND LANDING SLOTS

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	300	300	300	300	300	1,500

The Federal Aviation Administration (FAA) has established capacity controls at four airports: Kennedy International and La Guardia in New York; O'Hare International in Chicago; and Washington National in the District of Columbia. This proposal would charge fees for takeoff and landing rights at these airports on a permanent basis with a goal of $300 million in annual receipts. These receipts could be generated by auctioning the slots among the commercial airlines that use the airports. Receipts could be greater if this option were extended to other airports or if slots now reserved for commuter carriers and general aviation were also included in the auction.

Takeoff and landing slots were instituted in 1968 to control capacity and were allocated without charge by the FAA. A total of about 3,600 air carrier slots exist, with an additional 1,400 commuter and general aviation slots at the four FAA-controlled airports. Airlines are currently allowed to buy and sell slots among themselves, with the understanding that the FAA retains ultimate control and can withdraw the slots or otherwise change the rules on their use at any time. These slots have value because the demand for flights at times exceeds the capacity of the airports and the air traffic control system.

The main argument in favor of establishing charges for slots is that since the slots reflect the right to use scarce public airspace, airports, and air traffic control capacity, private firms and individuals should not receive all the benefits of this scarcity. They should share it instead with the public owners of these rights. Further, the charges would serve as incentives to put these scarce resources to their best use.

The main argument against this proposal is that the scarcity of slots at these airports arises principally from a lack of land and runway space; the fees are not intended to provide increased capacity. Further, if the current prices paid by airlines in the private sale of slots already accurately reflect their value, this proposal might not produce a better allocation of these scarce resources; only a redistribution of the benefits from their use between the private sector and the public would result.

A further argument against carrying out the proposal at this time is that new fees would worsen the already bleak financial condition of the airline industry. The airlines have had to contend recently with both excess capacity and a decline in passenger demand. In addition, aviation taxes were increased by 25 percent in fiscal year 1991.

ENT-20 ESTABLISH USER FEES FOR AIR TRAFFIC CONTROL SERVICES

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	700	1,450	1,550	1,600	1,700	7,000

The Federal Aviation Administration (FAA) manages the air traffic control (ATC) system, which serves commercial air carriers, military planes, and such smaller users as air taxis and private planes. Services provided include air traffic control towers that assist planes in takeoffs and landings, air route traffic control centers that guide planes through the nation's airspace, and flight service stations that assist smaller users. The FAA has more than 17,000 air traffic controllers as well as sophisticated software to perform these tasks. The total cost of operating, maintaining, and upgrading the ATC system was about $5.6 billion in 1993.

Currently, one-half of FAA operations are financed through annual appropriations from the general fund, whereas revenues from aviation excise taxes are used for a variety of purposes, such as facilities and equipment, research, engineering and development, and such non-ATC activities as airport improvement.

If users paid the marginal costs that the ATC incurs on their behalf, the deficit would be reduced by about $700 million in 1995 and $7 billion over the 1995-1999 period. This assumes that the new charges would be levied in the middle of fiscal year 1995.

Users would be charged according to the number of facilities they used on a flight and the marginal costs of their usage at each facility. The various classes of users would be affected differently. Smaller users, such as general aviation users, would experience comparatively greater increases in the cost of flying than larger users, such as commercial airlines.

Levying efficient fees presumably would oblige users to moderate their demands. Small users who are required to pay these costs would cut back on their consumption of ATC services, freeing controllers for other tasks and increasing the overall capacity of the system. An additional benefit of efficient fees is that, on the basis of user response, planners can judge how much new capacity is needed and where it should be located.

The main argument against this option is that it would raise the cost of ATC services. For commercial air carriers, this could contribute to their already difficult financial circumstances. For general aviation, it also could cause the demand for small aircraft produced in the United States to decline.

ENT-21 IMPOSE USER FEES ON THE INLAND WATERWAY SYSTEM

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	590	610	630	650	660	3,140

CBO estimates that the Congress annually appropriates about $700 million for the nation's system of inland waterways. Of this total, about $250 million is for operation and maintenance (O&M) and about $450 million is for construction. Current law allows up to 50 percent of inland waterway construction to be funded by revenues from the inland waterway fuel tax, a levy on the fuel consumed by barges using most segments of the inland waterway system. Revenues from the tax currently fund about 20 percent of federal outlays for inland waterway construction. All O&M expenditures are paid by general tax revenues.

Imposing user fees high enough to recover fully both O&M and construction outlays for inland waterways would reduce the federal deficit by $590 million in 1995 and $3.1 billion during the 1995-1999 period. The receipts could be considered tax revenues, offsetting receipts, or offsetting collections, depending on the form of the implementing legislation. These estimates do not take into account any resulting reductions in income tax revenues.

The advantage of this option is the beneficial effect of user fees on efficiency. Reducing subsidies to water transportation should improve resource allocation by inducing shippers to choose the most efficient transportation route, rather than the most heavily subsidized one. Moreover, user fees would encourage more efficient use of existing waterways, reducing the need for new construction to alleviate congestion. Finally, user fees send market signals that identify the additional projects likely to provide the greatest net benefits to society.

The effects of user fees on efficiency would depend in large measure on whether the fees were set at the same rate for all waterways or according to the cost of each segment. Since costs vary dramatically among the segments, systemwide fees would offer weaker incentives for cost-effective spending. In 1989, for example, O&M costs on the inland waterways ranged from less than 50 cents per 1,000 ton-miles on the lower Mississippi River (between the Ohio River and Baton Rouge) to about $140 per 1,000 ton-miles on the Allegheny River. A systemwide fee of $1.75 per 1,000 ton-miles would recover all O&M outlays but would do little to ration use of the system. Fees set for specific segments, by contrast, could cause users to abandon some segments.

One argument in favor of federal subsidies is that they may promote regional economic development. Assessing user fees would limit this promotional tool. Reducing inland waterway subsidies would also lower the income of barge operators and grain producers in some regions, but these losses would be small in the context of overall regional economies.

ENT-22 REDUCE SUBSIDIES TO STUDENTS FOR STAFFORD LOANS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Require Students to Pay In-School Interest			
Outlays	1,330	2,000	2,060	2,080	2,090	9,560
			Raise the Loan Origination Fee			
Outlays	250	330	320	320	310	1,530

The Federal Stafford Loan Program affords postsecondary students the opportunity to borrow funds to attend school. The Higher Education Amendments of 1992 created two programs within it--a "subsidized" program for students defined as having financial need, and an "unsubsidized" program for students with greater financial resources. In the subsidized program, the federal government incurs interest costs on the students' loans while they are in school; in the unsubsidized program, students are responsible for these interest costs, although the payments can be made after the students leave school.

The government recoups part of the cost of the program by collecting between 3 percent and 4 percent of the face value of each loan as an "origination fee." As a result of this fee, the federal government currently collects more funds from some students (for the most part, those who are in school for only a short period of time or are in the unsubsidized program) than it pays in subsidies for them.

Require Students to Pay In-School Interest. Federal subsidies could be reduced by requiring students to repay larger amounts than they do under current law. Charging interest on all new loans while borrowers are in school, but deferring actual payments until after they leave, would reduce federal outlays by $9.6 billion between 1995 and 1999.

This measure would not cause cash flow problems for students while they are in school because they would be allowed to defer interest payments during that period. Since the added costs would generally occur only after leaving school--when borrowers would be better able to afford them--most students would still be able to continue their educations. The larger repayments that would result from this change might, however, cause some students not to attend school or to limit their choices to lower-priced institutions.

Raise the Loan Origination Fee to 5 Percent. Raising the loan origination fee to 5 percent (the level before the Omnibus Budget Reconciliation Act of 1993) would reduce federal subsidies by a total of $1.5 billion during the next five years. It would, however, spread the lower subsidies over all borrowers, including the poorest.

ENT-23 REDUCE STAFFORD LOAN SPENDING BY INCLUDING HOME EQUITY IN THE DETERMINATION OF FINANCIAL NEED

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Outlays	60	85	85	85	85	400

The Higher Education Act of 1992 eliminated house and farm assets from consideration in determining a family's ability to pay for postsecondary education, thereby making it easier for many students to obtain federal Stafford loans. The Higher Education Act specifies formulas to calculate a family's need for Stafford loans. The amount the family is expected to contribute is determined by what is essentially a progressive tax formula. In effect, need analysis "taxes" family incomes and assets--excluding house and farm equity--above amounts assumed to be required for a basic standard of living.

Under this option, house and farm equity would be included in the calculation of a family's need for financial aid for postsecondary education. House and farm equity would be "taxed" at up to roughly 5.6 percent after a deduction for allowable assets (see DOM-40 for related savings in the Federal Pell Grant Program). In addition, the threshold under which most families with less than $50,000 in income are not asked to report any assets would also be lowered to its previous level of $15,000.

Outlays could be reduced by about $400 million during the 1995-1999 period by including house and farm equity and modifying the simplified need test. Families whose houses appreciated during the 1980s are now financially better off than they would have been if they had not owned a house then. Moreover, not counting this equity gives families who own a house an advantage over those who do not.

There is concern, however, that because increases in incomes have not kept pace with increases in housing prices for some families, they may have difficulty repaying their mortgages if they borrow against the equity in their houses. In addition, having to value their assets would complicate the application process for many families.

ENT-24 LIMIT THE GROWTH OF FOSTER CARE ADMINISTRATIVE COSTS TO 10 PERCENT A YEAR

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	0	20	40	40	50	150
Outlays	0	20	40	40	50	150

The federal foster care program, authorized under Title IV-E of the Social Security Act, is an open-ended entitlement program that provides federal matching funds to assist states in providing foster care to children who meet certain eligibility requirements. In 1995, the program is expected to serve about 255,000 children on average each month at a federal cost of $2.9 billion. Administration will account for about 42 percent of that total. Each state administers its own program within the federal mandates established in Title IV. The federal government reimburses states for one-half of certain administrative costs, including those for determining eligibility, certain preplacement services, and child placement services, as well as for administrative overhead.

Policymakers have been concerned about the rapidly escalating costs for administration in this program. Such costs increased from less than $50 million (in 1992 dollars) in 1981 to about $950 million in 1992. This option would limit annual increases in payments to each state for administrative costs to 10 percent a year, reducing federal outlays by $150 million in the 1995-1999 period.

During the 1980s, costs increased much more rapidly than caseloads. At some point in the past decade, many states' administrative costs increased sharply. In about one-half of the states, the annual increase in such costs per child exceeded 1,000 percent in at least one year, supporting the theory that much of the growth resulted from changes in states' methods for claiming funds rather than from expanded services to children.

It might not be advisable to slow the growth in federal funding to child welfare agencies now, however, when these agencies are struggling to deal with reported increases in child abuse and neglect. If states responded to the restriction by cutting back services, children in need of foster care could be harmed. Limiting the percentage increase that each state could receive would also lock in the current differences in costs per child. In 1992, estimates of average federal costs per child for Title IV-E administration ranged from less than $150 a month in three states to more than $500 a month in 10 states.

ENT-25 REDUCE THE 50 PERCENT FLOOR ON THE FEDERAL SHARE OF MEDICAID, AFDC, AND FOSTER CARE AND ADOPTION ASSISTANCE PAYMENTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Medicaid Outlays	4,950	5,560	6,210	6,950	7,780	31,450
AFDC Outlays	700	720	740	770	790	3,720
Foster Care/Adoption Assistance Outlays	210	290	310	340	380	1,530
Offsets in the Food Stamp Program	-130	-140	-140	-140	-150	-700
Total	5,730	6,430	7,120	7,920	8,800	36,000

The Medicaid program provides medical assistance to current or recent beneficiaries of the Aid to Families with Dependent Children (AFDC) program, low-income people who receive Supplemental Security Income, and certain other low-income individuals. The AFDC program provides cash assistance to low-income families in which one parent is absent or incapacitated or in which the primary earner is unemployed. The Foster Care and Adoption Assistance programs provide benefits and services to children in need.

The federal government and the states jointly pay for the Medicaid, AFDC, and Foster Care/Adoption Assistance programs. The federal share of the costs of these programs varies with a state's per capita income. High-income states pay for a larger share of benefits than low-income states. By law, the federal share can be no less than 50 percent and no more than 83 percent. The 50 percent federal floor currently applies to 14 jurisdictions: Alaska, California, Connecticut, Delaware, the District of Columbia, Hawaii, Illinois, Maryland, Massachusetts, Nevada, New Hampshire, New Jersey, New York, and Virginia.

Under this option, the 50 percent floor would be reduced to 45 percent, generating savings of about $5.7 billion in 1995 and $36 billion through 1999. Federal savings for the Medicaid program would be $4.9 billion in 1995 and $31.4 billion over the 1995-1999 period; outlays for AFDC would be reduced by $700 million in 1995 and $3.7 billion over the five-year period; and outlays for Foster Care/Adoption Assistance would decline by $210 million in 1995 and $1.5 billion over the five-year period. The estimates assume, however, that states would partially offset their higher costs by reducing benefits. Lowering AFDC payments would make some families eligible for larger Food Stamp benefits. Under this assumption, then, outlays for the Food Stamp program would increase by $130 million in 1995 and $700 million over the five-year period.

Proponents of this change argue that high-income states that choose to be generous should bear a larger share of the cost. If the floor were reduced to 45 percent, federal contribution levels would be more directly related to the state's income, and nine of the 14 jurisdictions would still be paying less than the formula alone would require. In January 1993, 10 of the 14 jurisdictions affected by this proposal paid AFDC benefits that were at or above the median when states were ranked by size of benefits (for a three-person family). The higher benefit levels in these states mean that more families are eligible for AFDC and thus for Medicaid.

Opponents of the change stress that the higher incomes and benefit levels in the affected states in part reflect higher costs of living. If this proposal

were adopted, the affected states would have to compensate for the lost federal grants by reducing Medicaid, AFDC, and Foster Care/Adoption Assistance benefits, lowering spending on other services, or raising taxes. If states chose to compensate by reducing benefits, as the estimates assume, program beneficiaries would be adversely affected.

ENT-26 MANDATE STATE REGULATION OF GROWTH IN THE NUMBER OF NURSING HOME BEDS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	35	75	120	170	225	625
Outlays	35	75	120	170	225	625

In 1993, nursing facility care absorbed about 60 percent of Medicaid long term care spending. The supply of nursing home beds varies widely across the country, however, and these variations can be explained only partly by differences in the number of elderly people among states. The rate at which available beds are used--on average, about 90 percent--also varies, but the occupancy rate seems not to be related to the number of beds per 1,000 people.

This option would mandate that states regulate growth in the number of nursing home beds eligible for federal funding through Medicaid, Medicare, or other federal programs by requiring that providers obtain a certificate of need (CON) to operate additional beds. For any specified area, states would issue a CON only if the ratio of the number of nursing home beds to the population that is likely to need them fell below certain guidelines. The guidelines would be set by the state, subject to federal approval. If the option were to reduce by one-half the growth rate of Medicaid nursing home beds in states with excess capacity, it would save $35 million in 1995 and $625 million over the 1995-1999 period.

If adding nursing home beds increases the number used, limiting the increase in the number of beds could help to curb further growth in Medicaid outlays for nursing home care in areas where the supply of nursing home beds is relatively high. In the process, regulating the number of beds could make nursing home outlays more predictable for state budget planners. Guidelines could also be used to help change the balance between nursing home and other forms of long-term care.

Conversely, such guidelines might shift Medicaid nursing home costs to the hospital sector if nursing home beds were not available for hospital patients who are eligible for Medicaid, or to the home- and community-based care sector in states where Medicaid pays for such care. Moreover, by sheltering existing providers against competition from new entrants, certificate-of-need processes could increase rates of return for existing providers and reduce their incentives to be efficient and provide high-quality care. Furthermore, some might view such guidelines as program caps implying the loss of Medicaid's open-ended budgetary commitment and hence the weakening of Medicaid's assurance of access to health care for poor or medically needy people.

ENT-27 REDUCE MATCHING RATES FOR ADMINISTRATIVE COSTS IN THE MEDICAID PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Reduce Matching Rates to 50 Percent						
Budget Authority	430	480	520	580	640	2,650
Outlays	430	480	520	580	640	2,650
Reduce Matching Rates to 45 Percent						
Budget Authority	770	850	930	1,030	1,130	4,710
Outlays	770	850	930	1,030	1,130	4,710

The Medicaid program provides medical assistance to low-income people who are recipients of Supplemental Security Income or current or recent recipients of Aid to Families with Dependent Children and to certain other low-income individuals. The federal government pays half of most administrative costs; state and local governments pay the remaining share. Higher matching rates have been set up for some types of expenses as an incentive for local administrators to undertake more of a particular administrative activity than they would if such expenses were matched at 50 percent. For example, enhanced matching rates are applied to the costs of automating claims processing, reviewing medical and health care use, and establishing and operating fraud control units.

Reducing the higher matching rates to 50 percent would decrease federal outlays by about $0.4 billion in 1995 and by $2.6 billion over the 1995-1999 period. Considerably greater savings would be generated if all the matching rates for administrative costs were reduced to 45 percent, since an additional 5 percent of the total administrative expenses would be shifted to the states. Federal outlays would fall by $0.8 billion in 1995 and by $4.7 billion over the 1995-1999 period.

Reducing the higher matching rates to 50 percent would be appropriate if the need to provide special incentives for these activities no longer exists. For example, all state Medicaid programs already have established computer systems and are currently operating units to control fraud and abuse. Reducing all matching rates to 45 percent would provide states with stronger incentives to reduce administrative inefficiencies, since the states would be liable for a greater share of the cost of such inefficiencies.

States might respond to either option by reducing their administrative efforts, however, and might thereby raise program costs and offset some of the federal savings. Specifically, states might make less effort to eliminate waste and abuse in payments to providers. In addition, this proposal might harm recipients by encouraging states to limit services provided under Medicaid in order to constrain total costs.

ENT-28 ELIMINATE THE DISPROPORTIONATE SHARE ADJUSTMENT FOR HOSPITALS IN MEDICARE'S PROSPECTIVE PAYMENT SYSTEM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
	Immediately Eliminate the Disproportionate Share Adjustment					
Outlays	3,100	3,800	4,100	4,450	4,850	20,300
	Gradually Eliminate the Disproportionate Share Adjustment					
Outlays	600	1,400	2,350	3,450	4,750	12,550

NOTE: The disproportionate share adjustment is based on an index that is the sum of two ratios: the proportion of all Medicare patient days that are attributable to Medicare patients receiving benefits from the means-tested Supplemental Security Income program, and the proportion of all patient days for which Medicaid is the primary payer.

Under Medicare's prospective payment system (PPS), higher rates are paid to hospitals with a disproportionately large share of low-income patients. In 1985, the Congress added this "disproportionate share" adjustment to account for the presumed higher costs of treating Medicare beneficiaries at these hospitals. One rationale for the adjustment is that low-income Medicare patients may be sicker and, therefore, more expensive to treat than other Medicare patients. Another rationale is that hospitals with large numbers of low-income patients may provide additional staffing, facilities, and services in response to such patients' needs. In 1995, outlays for disproportionate share payments are expected to total $3.1 billion, or about 5 percent of all PPS payments. Large urban hospitals--those with 100 or more beds--will receive about 96 percent of the disproportionate share payments, compared with approximately 85 percent of all PPS payments.

Data on hospitals' costs provide only limited support for any disproportionate share adjustment. Although more than 1,800 hospitals receive disproportionate share payments, the only group for which such an adjustment would be supported by the data is large urban hospitals that have extremely high values of the disproportionate share index. This group contains approximately 150 hospitals and accounts for about one-fifth of all disproportionate share payments.

If the disproportionate share adjustment were eliminated immediately, outlays would fall by $20.3 billion over the 1995-1999 period. Phasing out the disproportionate share adjustment by the end of 1999 would reduce outlays by about $12.6 billion over the same five years. Alternatively, the adjustment could be eliminated for all hospitals except large urban institutions with the highest disproportionate share indexes. If the adjustment were restricted to that group and lowered to 5 percent--the level suggested by the cost data--savings for the five-year period would be about $440 million less under the first option and about $280 million less under the second one.

Without the disproportionate share adjustment, Medicare's payments to all hospitals would be similar in relation to their costs of treating Medicare beneficiaries. Phasing out the adjustment over several years would give affected hospitals time to adjust. Nevertheless, many of those institutions are in poor financial condition and, since 1990, Medicare's PPS payments to hospitals have been less, on average, than the costs of treating patients who are covered. If eliminating the disproportionate share adjustment led some of them to cut back on charity care, or if some were forced to close, residents of the areas the hospitals serve could have less access to care.

ENT-29 REDUCE MEDICARE'S PAYMENTS FOR THE INDIRECT COSTS OF PATIENT CARE THAT ARE RELATED TO HOSPITALS' TEACHING PROGRAMS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
	Reduce the Teaching Adjustment to 6 Percent					
Outlays	730	890	970	1,050	1,150	4,790
	Reduce the Teaching Adjustment to 3 Percent					
Outlays	2,050	2,500	2,750	3,000	3,250	13,550

The Social Security Amendments of 1983 established the current prospective payment system (PPS) under which Medicare reimburses hospitals for inpatient services provided to beneficiaries. Higher rates are paid to hospitals with teaching programs to cover their additional costs of caring for Medicare patients. In particular, payments to these hospitals are raised by approximately 7.7 percent for each 0.1 increase in a hospital's ratio of full-time-equivalent interns and residents to its number of beds. This adjustment was included both to compensate hospitals for their indirect teaching costs--such as the greater number of tests and procedures thought to be prescribed by interns and residents--and to cover higher costs caused by factors that are not otherwise accounted for in setting the PPS rates. These factors include severity of illness within diagnosis-related groups, location in inner cities, and a more costly mix of staffing and facilities--all of which are associated with large teaching programs.

Estimates based on data from the 1984-1990 period suggest that the teaching adjustment could be lowered to a value in the range of 2 percent to 7 percent, depending on which year's data are used and which of many possible estimating assumptions are chosen. If the teaching adjustment were lowered to 6 percent, outlays would fall by about $4.8 billion over the 1995-1999 period. Alternatively, if the teaching adjustment were lowered to 3 percent, outlays would fall by about $13.5 billion over that period.

This option would better align payments with the actual costs incurred by teaching institutions. It would, however, considerably reduce payments to teaching hospitals. If these hospitals now use some or all of the excess payments to fund activities such as charity care, access to and quality of care could diminish for some people.

ENT-30 REDUCE MEDICARE'S DIRECT PAYMENTS FOR MEDICAL EDUCATION

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Outlays	170	200	220	230	250	1,070

Medicare's prospective payment system does not include payments to hospitals for the direct costs they incur in providing graduate medical education (GME); that is, residents' salaries and fringe benefits, teaching costs, and institutional overhead costs. Instead, these payments are made separately, but also prospectively, based on Medicare's share of a hospital's 1984 cost per resident indexed for subsequent increases in the level of consumer prices. Medicare's GME payments, which are received by about one-fifth of hospitals, totaled $1.3 billion in 1993.

This option would reduce teaching and overhead payments for nonprimary care residents in their initial residency period and eliminate these payments for nonprimary care residents beyond their initial residency period, but continue to pay their salaries and fringe benefits. Hospitals' GME payments would be based on the national average salary paid to residents in 1987, updated annually by the consumer price index for urban areas. Reimbursement for primary care residents would be based on 175 percent of the national average salary. This weighting provides a payment amount close to the average that Medicare pays per resident under the current system. The corresponding weights for nonprimary care residents in their initial residency period and nonprimary care residents beyond their initial residency period would be 145 percent and 120 percent, respectively. The savings over the 1995-1999 period would total about $1.1 billion.

Unlike the current system, in which GME payments vary considerably from hospital to hospital, this option would pay every hospital the same amount for the same type of resident. Efficient hospitals would be rewarded by being able to keep any excess reimbursement over the cost of training, and inefficient hospitals would be penalized. The overall reduction in the level of subsidies might be warranted since the United States as a whole is facing a projected surplus of physicians. Moreover, since graduate training contributes to the ability of physicians to earn higher incomes, they might reasonably contribute more to these costs themselves. This reallocation would occur if hospitals responded to the reimbursement changes by cutting residents' salaries or fringe benefits.

Reducing Medicare's GME payments could have some drawbacks, however. Some physicians incur substantial debts during their medical education, which they must pay off when they begin to practice. If hospitals lowered residents' salaries or benefits, physicians might be further discouraged from entering primary care or locating their practices in low-income areas. Decreasing GME reimbursement could force some hospitals to reduce the resources they commit to training, jeopardizing the quality of their medical education programs.

ENT-31 ELIMINATE MEDICARE'S ADDITIONAL PAYMENTS TO SOLE COMMUNITY HOSPITALS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Outlays	210	250	270	290	310	1,330

Under Medicare's prospective payment system (PPS) for inpatient hospital services, special rules apply to providers designated as sole community hospitals (SCHs). At present, there are about 680 SCHs, more than 90 percent of which are located in rural areas. Thus, more than one-fourth of rural hospitals qualify for SCH status. Estimates indicate that in 1995 almost two-thirds of SCHs will receive higher payments as a result of being in this category.

Under the current rules, a hospital may be designated as an SCH if it meets specific criteria that define a sole provider of inpatient, acute care hospital services in a geographic area. In addition, many SCHs have been permitted to continue that status regardless of whether they meet the current sole-provider criteria.

Payments to SCHs are equal to the highest of three amounts: the regular PPS payment that would otherwise apply, an amount based on the hospital's costs in 1982 updated to the current year, or an amount based on the hospital's costs in 1987 updated to the current year. In addition, rural SCHs receive a higher "disproportionate share" adjustment--that is, a higher PPS adjustment for hospitals that treat a disproportionately large share of low-income patients--than other rural hospitals. As a result of the special rules, total PPS payments to SCHs for 1995 are estimated to be about 10 percent higher than they would be otherwise. If the special payment rules for SCHs were eliminated, total PPS payments would be $210 million less in 1995 and $1.3 billion less for the 1995-1999 period.

A primary objective of the SCH rules is to assist hospitals whose closings would threaten access to hospital care in rural areas, but the support is not well targeted toward essential providers. The group of hospitals qualifying for SCH payments includes, for example, some hospitals located in areas with other nearby providers. Moreover, whether an SCH actually receives higher payments under the special rules that permit payments to be based on a hospital-specific amount depends on whether its costs in either of the specified base years (1982 or 1987) were relatively high, not on its current financial condition.

If the special payment rules were eliminated, however, revenues of many SCHs would be lower, which might cause financial distress for some of them. Because many SCHs are the sole providers of hospital services in their geographic areas, quality or access to care might be reduced in some rural locations.

ENT-32 FREEZE MEDICARE'S HOSPITAL INSURANCE PAYMENT RATES AND LIMITS FOR ONE YEAR

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Outlays	1,300	1,600	1,700	1,850	2,000	8,450

Medicare's Hospital Insurance (HI) program uses predetermined rates to pay for care in most inpatient hospital settings, hospices, and some skilled nursing facilities. For other services covered by the HI program, Medicare's payments are based on the provider's reasonable costs, subject to specified limits. Usually, Medicare's payment rates and limits are increased each year.

Payments for operating and capital-related expenses in hospitals covered by Medicare's prospective payment system (PPS) account for about 65 percent of HI payments. To pay for the operating costs of inpatient hospital services, the PPS uses a preset amount for each beneficiary that varies according to the patient's diagnosis and certain characteristics of the hospital. The annual increase in PPS rates is usually tied to the increase in an index of hospital costs known as the hospital market-basket index (MBI). For fiscal year 1995, under the Omnibus Budget Reconciliation Act of 1993 (OBRA-93), the increase in PPS rates for urban areas will be the percentage increase in the MBI minus 2.5 percentage points, and the increase for rural areas will be the amount necessary to make the rural rates equal the rates for urban areas with 1 million or fewer people. Based on the Congressional Budget Office's current estimate of 4.7 percent growth in the MBI in 1995, the increase in payment rates will be 2.2 percent for urban areas and 5.8 percent for rural areas, or 2.6 percent on average. In addition to payments for operating expenses, Medicare pays hospitals that are covered by the PPS a separate prospective amount for capital-related expenses based on the number of beneficiaries treated. CBO estimates that in 1995 these per-case payment rates will increase by 4.3 percent. The other 35 percent of payments from the HI program are for inpatient hospital services not covered by the PPS, services provided in skilled nursing facilities, home health care, and hospice care.

Under this option, Medicare would freeze all HI payment rates and limits for 1995 at their 1994 levels and would delay for one year the equalization of PPS rates for rural areas and urban areas with 1 million or fewer people. This would not affect the payment limits that apply to most skilled nursing facility care and home health care because they are already frozen in 1995, at 1994 levels, by OBRA-93. The one-year freeze would save \$1.3 billion in 1995 and \$8.5 billion over the 1995-1999 period.

In response to the freeze, some facilities could increase their efficiency or absorb the reductions through lower profits or by increasing their revenues from other sources. It might be difficult, however, for others to adjust to the cuts. For example, the Prospective Payment Assessment Commission estimates that in 1991 nearly one-fourth of hospitals had greater total costs than revenues. As a result, some Medicare beneficiaries might encounter reduced access to hospital and other services or lower-quality care. In addition, some facilities might cut back the amount of uncompensated care they provide to patients who are uninsured and not able to pay for care.

ENT-33 CONTINUE MEDICARE'S TRANSITION TO PROSPECTIVE RATES FOR FACILITY COSTS IN HOSPITAL OUTPATIENT DEPARTMENTS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Outlays	45	65	70	75	85	340

The Medicare program pays for services provided in hospital outpatient departments that bill separately for facilities and physicians. The facility component includes reimbursement for the services of non-physician personnel, drugs and biological products, other health services, rent, and utilities. Medicare previously reimbursed hospital outpatient departments on a reasonable-cost basis for most services. The Omnibus Budget Reconciliation Act of 1986, however, changed Medicare's payment method for most surgical procedures performed in hospital outpatient departments. The reimbursement that hospitals receive for these procedures is now based on the lesser of reasonable costs or charges, or a blend of reasonable costs or charges and the prospective rate received by free-standing ambulatory surgical centers (ASCs) in the area. In 1987, the Congress enacted a similar change for paying facility costs associated with outpatient radiology and diagnostic services. In both cases, the hospital-specific share is currently 42 percent and the prospective-rate share is 58 percent.

Outpatient payments are one of the fastest-growing components of Medicare expenditures, accounting for a projected 19 percent of Supplementary Medical Insurance (SMI) payments in 1994. Between 1995 and 1999, SMI outlays for hospital outpatient services are expected to increase at an average annual rate of about 16 percent. A major factor in this increase is technological progress that allows hospitals and physicians to substitute outpatient surgical procedures and technologies for inpatient procedures. Furthermore, under the current reimbursement system, hospitals have little incentive to reduce the expenses of ambulatory surgery or outpatient radiology because that would result in lower payments. By contrast, ASCs have strong incentives to control costs because they are reimbursed prospectively, as are physicians who provide radiology services in their offices.

Under this option, the hospital-specific portion of the blended reimbursement rate for the facility costs of outpatient surgery, radiology, and diagnostic services would be phased out in 1996, with a transitional blend for 1995 of 25 percent of costs and 75 percent of the prospective rate. Savings to the Medicare program would be $45 million in 1995 and $340 million over the 1995-1999 period.

In addition to reducing Medicare's costs, this option would result in the same payment system for hospital outpatient departments and ASCs. Thus, it would reduce the incentive and ability of hospitals to compete for patients through costly capital acquisitions. Hospitals would also have stronger incentives to control the costs of outpatient surgery, radiology, and diagnostic services because they could no longer automatically pass part of these costs through to Medicare. Some people are concerned, however, that access to care for rural Medicare beneficiaries might deteriorate; small and rural hospitals are more dependent on outpatient revenue than larger hospitals and there are fewer alternatives to outpatient hospital services in rural areas. In addition, if patients at risk of complications are advised to receive treatment in hospital outpatient departments rather than ASCs because of the ready availability of advanced support systems in hospitals, paying higher rates to hospitals than to ASCs might be appropriate.

ENT-34 INCREASE AND INDEX MEDICARE'S DEDUCTIBLE FOR PHYSICIANS' SERVICES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Outlays	790	1,480	1,880	2,330	2,810	9,290

One way to achieve appreciable federal savings in Medicare's Supplementary Medical Insurance (SMI) program is to increase the deductible--that is, the amount that enrollees must pay for services each year before the government shares responsibility. The deductible is now $100 a year and has been increased only three times since Medicare began in 1966, when it was set at $50. The deductible has fallen in relation to average annual per capita charges under the SMI program from 45 percent in 1967 to about 5 percent in 1993. In relation to the average annual Social Security benefit, the deductible has dropped from 5 percent in 1967 to 1 percent in 1993.

Increasing the SMI deductible to $150 on January 1, 1995, would save $790 million in fiscal year 1995. If the new deductible were indexed to the rate of growth in SMI charges per enrollee for 1996 and later years, savings would be $9.3 billion over the 1995-1999 period, and net outlays for SMI would be reduced by 3 percent. By 1999, the deductible amount would be $226.

An increase in the deductible amount would enhance the economic incentives for prudent consumption of medical care, while spreading the burden among most enrollees. No enrollee's out-of-pocket costs would rise by more than $50 in 1995.

The additional out-of-pocket costs under this option might, however, discourage some low-income enrollees who are not eligible for Medicaid from seeking needed care. In addition, costs to states would increase because their Medicaid programs pay deductible amounts for Medicare enrollees who also receive Medicaid benefits.

ENT-35 INCREASE THE SMI COINSURANCE RATE TO 25 PERCENT

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Outlays	2,630	2,950	3,010	3,590	4,070	16,250

Currently, the coinsurance rate on most services provided under the Supplementary Medical Insurance (SMI) program is 20 percent. One exception is outpatient psychiatric services, for which the coinsurance rate is 50 percent. The other exceptions are clinical laboratory services and home health care, which have no coinsurance requirements.

If enrollees were required to pay coinsurance rates of 25 percent on all services that are currently subject to a coinsurance rate of 20 percent, savings to Medicare would be $2.6 billion in fiscal year 1995. Over the 1995-1999 period, savings would be $16.3 billion, reducing net SMI outlays by 5 percent.

This option would reduce Medicare's costs for two reasons. First, the higher coinsurance rate would reduce use of services by Medicare enrollees who do not have supplementary insurance coverage. Second, Medicare would be responsible for a smaller share of the costs of the services that enrollees use.

This option would increase the risk of very large out-of-pocket costs for the 20 percent to 25 percent of enrollees who have no supplementary coverage, however, and would probably increase medigap premiums for the 30 percent of enrollees who purchase that kind of supplementary insurance. Moreover, it would increase states' Medicaid costs for the 15 percent to 20 percent of enrollees who receive full or qualified Medicaid benefits.

ENT-36 COLLECT 20 PERCENT COINSURANCE ON CLINICAL LABORATORY SERVICES UNDER MEDICARE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Outlays	685	1,145	1,290	1,445	1,615	6,180

Medicare currently pays 100 percent of the approved fee for clinical laboratory services provided to enrollees. Medicare's payment is set by a fee schedule, and providers must accept that fee as full payment for the service. Beneficiaries pay coinsurance of 20 percent for most other services provided under Medicare's Supplementary Medical Insurance (SMI) program (as they did for clinical laboratory services before July 1984, when a fee schedule that reduced payment rates was put in place).

Reimposing the coinsurance requirement for laboratory services would yield appreciable savings to Medicare. If coinsurance of 20 percent of laboratory fees were imposed beginning January 1, 1995, federal savings would be $685 million in fiscal year 1995. Savings would total nearly $6.2 billion over the 1995-1999 period, reducing net SMI outlays by about 2 percent.

In addition to reducing Medicare's costs, this option would make cost-sharing requirements under the SMI program more uniform and therefore easier to understand. Moreover, enrollees might be somewhat less likely to have laboratory tests with little expected benefit if they paid part of the costs.

Cost sharing probably would not substantially affect the use of laboratory services by enrollees, however, because decisions about what tests are appropriate are generally left to physicians, whose decisions do not appear to depend on enrollees' cost sharing. Hence, CBO assumes that a small part of the savings under this option would be the result of more prudent use of laboratory services, while most of the expected savings reflect the transfer to enrollees of costs now paid by Medicare. Billing costs for some providers, such as independent laboratories, could be greatly increased because they would have to bill both Medicare and enrollees to collect their full fees. Currently, they have no need to bill enrollees directly for clinical laboratory services.

ENT-37 COLLECT 20 PERCENT COINSURANCE ON ALL HOME HEALTH AND SKILLED NURSING FACILITY SERVICES UNDER MEDICARE

Savings from CBO Baseline	Annu (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Outlays for Home Health	2,265	3,670	4,210	4,610	5,015	19,770
Outlays for Nursing	40	95	150	185	210	680
Total	2,305	3,765	4,360	4,795	5,225	20,450

Currently, copayments are not required from enrollees for home health services under Medicare. Copayments for skilled nursing facility (SNF) services are required for each day after the first 20 days of care; the coinsurance amount per day is equal to one-eighth of the deductible amount for hospital care and is unrelated to SNF costs.

If enrollees were required to pay coinsurance amounts equal to 20 percent of the projected average cost for each home health visit and each SNF day, the net savings to Medicare would be $2.3 billion in fiscal year 1995. Over the five-year projection period, savings would be nearly $20.5 billion.

This option, together with the laboratory coinsurance requirement discussed in ENT-36, would establish a uniform coinsurance rate of 20 percent on almost all Medicare services. This uniform rate would make Medicare's copayment requirements easier for providers and patients to understand. Further, because coinsurance amounts would be based on the cost of services, they would encourage enrollees who lack supplementary insurance coverage to consider relative costs appropriately when choosing among alternative treatments. As a result, the use of home health and SNF services might fall. Only hospital inpatient services would require no copayments (for most stays) except for the deductible amount. But under the prospective payment system, patients are unlikely to remain hospitalized longer than necessary because hospitals have strong incentives to discharge them quickly.

However, many enrollees have supplementary insurance coverage that eliminates their Medicare copayment costs, and this option would not affect the use of services by those enrollees. Moreover, this option would increase the risk of very large out-of-pocket costs for the 20 percent to 25 percent of enrollees who lack any supplementary coverage, and would probably increase medigap premiums for about 30 percent of enrollees who purchase that kind of supplementary insurance.

ENT-38 ELIMINATE MEDICARE PAYMENTS TO HOSPITALS FOR ENROLLEES' BAD DEBTS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
Outlays	270	330	360	380	410	1,750

Medicare beneficiaries are responsible for certain deductible and coinsurance amounts when they receive hospital inpatient services. For example, for calendar year 1994, the deductible amount for inpatient services is $696 per spell of illness. Currently, if the hospital makes a reasonable effort to collect these copayment amounts, Medicare will reimburse it for any remaining unpaid amounts. Eliminating these payments for enrollees' bad debts would reduce Medicare's payments to hospitals by $270 million in 1995 and $1.8 billion over the 1995-1999 period.

This option would give hospitals a financial incentive to expand their collection efforts, which would probably increase their recovery of enrollees' deductible and coinsurance amounts. Hospitals would not be able, however, to collect all the owed amounts. In particular, low-income enrollees who are not covered by Medicaid or other insurance may not be able to pay their hospital bills. As a result, this option would reduce revenues most for those hospitals that are most likely to serve low-income Medicare patients. A drop in their Medicare payments might cause hospitals to cut back on the quality of their services or the amount of uncompensated care they provide, or to raise the rates they charge for other patients' care.

ENT-39 INCREASE THE PREMIUM FOR PHYSICIANS' SERVICES UNDER MEDICARE TO 30 PERCENT OF PROGRAM COSTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Outlays	0[a]	2,560	3,920	4,490	6,400	17,370

a. The premium set in law for 1995 will cover a little more than 30 percent of program costs under current projections. The estimates assume no change in the premium for 1995.

Benefits under Medicare's Supplementary Medical Insurance (SMI) program are partially funded by monthly premiums paid by enrollees, and the remainder are paid from general revenues. Although the SMI premium was initially intended to cover 50 percent of the cost of benefits, between 1975 and 1983 premium receipts covered a declining share of SMI costs--falling from 50 percent to less than 25 percent. This drop occurred because premium increases were limited by the cost-of-living adjustment (COLA) for Social Security benefits (which is based on the consumer price index), but the per capita cost of the SMI program increased faster. Since 1984, premiums have been set to cover about 25 percent of average benefits for an aged enrollee, although under current law the COLA will again limit the premium beginning with the 1999 increase.

If the premium were set to cover 30 percent of benefits for 1996 and for all years thereafter, $2.6 billion would be saved in fiscal year 1996 and $17.4 billion over the 1996-1999 period. Net outlays for SMI would be reduced by about 5 percent over this period. The premium for 1996 would be $51.90 a month, instead of $43.30. These estimates assume a continuation of the current hold-harmless provision, which ensures that no enrollee's monthly Social Security check will fall as a result of the Social Security cost-of-living adjustment (which is based on the whole benefit) being smaller than the SMI premium increase.

All SMI enrollees would pay a little more under this option, in contrast to proposals--such as increasing copayments--that could substantially increase the out-of-pocket costs of those who become seriously ill. This option need not affect enrollees with incomes below the federal poverty threshold because all of them are eligible to have Medicaid pay their Medicare premiums, although some who are eligible for Medicaid do not apply for benefits.

Low-income enrollees who are not eligible for Medicaid, however, could find the increased premium burdensome. A few might drop Supplementary Medical Insurance coverage and either do without care or turn to sources of free or reduced-cost care, which could increase demands on local governments. In addition, states' expenditures would rise because states would pay part of the higher premium costs for the nearly 20 percent of Medicare enrollees who are also eligible for Medicaid.

ENT-40 RELATE THE PREMIUM FOR PHYSICIANS' SERVICES UNDER MEDICARE TO ENROLLEES' INCOMES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			50 Percent Ceiling			
25 Percent Basic Premium	0	0	0	0	1,295	1,295
Income-Related Premium	155	890	940	1,210	1,530	4,725
Total	155	890	940	1,210	2,825	6,020
			100 Percent Ceiling			
25 Percent Basic Premium	0	0	0	0	1,295	1,295
Income-Related Premium	160	840	825	1,020	1,235	4,080
Total	160	840	825	1,020	2,530	5,375

Instead of increasing the basic premium to 30 percent of costs for all enrollees under the Supplementary Medical Insurance (SMI) program, this option would collect relatively more from higher-income people. Under one version, individuals with modified adjusted gross incomes of less than $50,000 and couples with incomes lower than $65,000 would pay only the basic premium, set at about 25 percent of SMI costs per enrollee. Premiums would rise progressively for higher-income enrollees, however. The maximum total premium would be set to cover 50 percent of costs for individuals with incomes exceeding $60,000 and for couples with incomes exceeding $80,000.

Under a second version, nearly the same five-year savings could be achieved by setting the maximum total premium to cover 100 percent of costs for individuals with incomes exceeding $125,000 and for couples with incomes over $150,000. Under this version, income-related premiums would begin at $100,000 for individuals and $125,000 for couples. In both cases, the income-related premiums would have to be collected through the income tax system so that rates could be aligned with income. Current premiums are deducted automatically from Social Security checks for most enrollees.

If the 50 percent option were carried out for 1995, savings would total $155 million in fiscal year 1995 and $6.0 billion over the 1995-1999 period. Under the 100 percent option, savings would total $5.4 billion over the five-year period. These estimates assume that the current hold-harmless provisions would continue only for those subject to the basic 25 percent premium. (The hold-harmless provisions ensure that no enrollee's Social Security check would decrease because an increase in the SMI premium exceeded the cost-of-living adjustment.) Under both options, about 25 percent of the five-year savings would come from keeping the basic SMI premium at 25 percent through 1999.

Most enrollees would be unaffected by the income-related portion of the premium. Under the 50 percent option, roughly 94 percent of enrollees would face the basic 25 percent premium, about 4 percent would [illegible]e maximum premium, and 2 percent would [illegible] premium somewhere in between. Under the [illegible]00 percent option, only about 2 percent of enrollees would be subject to the income-related premium.

Enrollees subject to the income-related premium would pay substantially more, however. Under the 50 percent option, the maximum monthly premium

for 1995 would be $75.40 instead of the $46.10 premium set by current law. Under the 100 percent option, the maximum monthly premium would be $150.70. This might lead some enrollees to drop out, although it is estimated that fewer than 0.5 percent of all enrollees would do so. Those with retirement health plans that do not require Medicare enrollment (largely retired government employees) would be most likely to drop out, but some healthy enrollees who have no other source of health insurance might do so as well.

ENT-41 REDUCE FEDERAL EMPLOYEE RETIREMENT BENEFITS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Defer COLAs for Retirees			
Military Retirement	0	380	770	1,200	2,100	4,450
Civilian Retirement	60	170	270	330	380	1,210
			Limit Some COLAs Below Inflation			
Military Retirement	0	230	480	760	1,300	2,770
Civilian Retirement	90	270	500	690	900	2,450
			Modify the Salary Used to Set Pensions			
Military Retirement	20	20	20	20	30	110
Civilian Retirement	10	40	90	150	220	510
			Restrict Agency Match on Thrift Plan Contribution to 50 Percent			
Civilian Retirement	390	430	470	510	540	2,340
			Raise Employee Contributions			
Civilian Retirement	380	870	990	980	960	4,180

About 4.6 million government employees are covered by federal civilian and military retirement programs. The Federal Employees' Retirement System (FERS) covers civilian employees hired since January 1984. FERS supplements Social Security, in which workers who are covered under FERS also participate. Workers hired before 1984 had the option to join FERS when it was created. Most civilian employees not in FERS are covered by the Civil Service Retirement System (CSRS). Employees who are covered under CSRS do not participate in Social Security. Uniformed military personnel are covered by the Military Retirement System (MRS), which was revised for personnel entering the service after July 31, 1986. All told, federal retirement payments amounted to more than $60 billion in 1993.

The main argument for cutting federal retirement costs is that benefits are more generous than those typically offered by firms in the private sector. Even if federal retirement were reduced in the manner described below, federal retirees would still receive benefits that exceed those typically received by employees retiring from private firms. Reducing selected federal retirement benefits and increasing pay would produce a mix of current and deferred compensation more in line with standards in the private sector. In addition to lowering costs, such efforts might facilitate downsizing.

The main arguments against cutting retirement are that such action hurts both retirees and the government's ability to recruit a quality work force. Opponents also argue that while certain provisions of retirement are generous, federal compensation in general and pay in particular compares poorly with the private sector. These opponents view relatively generous pensions as recompense for working long years at below-market federal salaries.

There are two basic approaches to reducing the costs of federal retirement, namely, cutting benefits or increasing employee contributions. The options

described here differ according to who would be affected. The increase in contributions, for example, affects workers who must contribute more of their income toward future benefits. By contrast, the options limiting cost-of-living allowances (COLAs) affect current retirees. The other options affect current employees and future retirees.

Depending on how they are designed, some of the cuts in benefits could promote efforts to reduce employment because some workers would leave before reductions took effect. This would be especially true if employees were offered cash as an added inducement to separate. In the long run, however, changes in benefits could encourage workers to stay in service longer.

It is important to note that the five-year cash estimates for the cuts in benefits described here represent only a small portion of the long-run savings that would result from a reduction in federal retirement costs. The budgetary savings that would result during the next five years from various cuts may understate the long-run savings to taxpayers. One reason is that the options are phased in at different rates, so that the first year's cash savings are relatively small. An even more important reason is that the cash flows and costs are accounted for differently in different options. For example, the bulk of the cash savings from modifying the salary used to compute pensions shows up years or decades in the future, when current employees retire. By contrast, the option of raising employee contributions counts as an immediate saving that future taxpayers will not have to pay for benefits. Given this phenomenon, the relative size of savings over five years for each option may not be an accurate guide to the long-run advantage of each for reducing the budget. (The estimates exclude savings realized by the Postal Service because it is now off-budget and its operating cost reductions eventually benefit only mail users.)

Defer Cost-of-Living Adjustments. The CSRS and the prereform MRS (covering new recruits before August 1, 1986) provide full cost-of-living protection to all retirees, even those who retire before they are 62 years old. Such protection is expensive when compared with that available under the largest and most generous private pensions. Deferring COLAs until age 62 for all nondisabled employees who retire before that age would yield savings of $5.7 billion over five years. (Nearly 80 percent of the estimated savings would derive from MRS because more than one-half of its annuitants are nondisabled retirees under 62, most of whom retired in their 40s.)

If COLAs were deferred, the result would be a moderation of the government's retirement costs and would be more in line with the treatment of COLAs under FERS and the postreform MRS. (Consistent with the MRS reforms, this option allows a catch-up adjustment at age 62 that reflects inflation after the date of retirement. Retirees under FERS receive neither protection nor a catch-up at age 62.) Although the option would lower the compensation of affected workers after retirement, many retirees should be able to supplement their pensions by working--as most military retirees already do. (As an alternative to eliminating COLAs, retirees who have not reached the age of 62 could be granted COLAs equal to one-half of the inflation rate with no catch-up provision. This option offers retirees under 62 some insurance against excessively high inflation. The plan parallels changes that were mandated in 1982 but subsequently repealed, and would result in savings of about $3.2 billion over five years.)

Limit Some COLAs. Current indexing of benefits is expensive and generous when compared with practice in the private sector. Most private pension plans that allow for any adjustment of postretirement benefits do so on a sporadic basis that may cover about 30 percent of the erosion caused by inflation. Inflation protection for other sources of retirement income, such as Social Security and employer-sponsored thrift plans, could boost the inflation coverage for a typical worker in the private sector to as much as 70 percent. By contrast, CSRS and the prereform MRS provide 100 percent automatic protection from inflation.

This option would limit COLAs to 1 percentage point below the rate of inflation for the old MRS and to one-half point below inflation for CSRS. (The smaller half-point limitation for CSRS would apply to a more comprehensive benefit that, unlike the defined benefits under FERS and MRS, substi-

tutes for both Social Security and employer-sponsored benefits. Therefore, the smaller cut would produce a reduction comparable to the one-point limit for MRS employees.) These changes would conform to the postretirement COLAs for employees under FERS and the revised MRS. This option, however, would hurt low-income retirees most. It would also renege on an understanding that workers in CSRS who passed up the chance to switch systems would retain their full protection against inflation. Savings would amount to $5.2 billion through 1999. (Savings would decrease to $3.4 billion if this option were coupled with the preceding one that would defer COLAs until age 62.)

Modify the Salary Used to Set Pensions. Under current law, CSRS and FERS provide initial benefits based on an average of the employee's three highest-salaried years. MRS uses a different salary base for personnel hired before September 1980; benefits are calculated using the salary at the date of retirement. If, instead, a four-year average were adopted for CSRS and FERS and a 12-month average were adopted for MRS, initial pensions for most new retirees would be about 2 percent to 3 percent smaller, producing total savings through 1999 of $620 million. This option would align federal practice more closely with practice in the private sector, where five-year averages are common. In the long run, this option could encourage some employees to stay on another year in order to take full advantage, when calculating retirement benefits, of the higher salaries that may occur over time. This could help the government keep experienced people, but hinder efforts to reduce federal employment.

Restrict Matching Contributions. On behalf of any worker covered by FERS, federal agencies automatically contribute 1 percent of individual earnings to the Thrift Savings Plan (TSP). In addition, the employing agency matches any voluntary employee deposits dollar-for-dollar for the first 3 percent of pay and 50 cents for each dollar thereafter up to a 5 percent maximum. The entire federal contribution for employees putting aside 5 percent amounts to a sum equal to 5 percent of pay. If the government limited its matching contributions to a uniform 50 percent rate against the first 5 percent of pay, discretionary savings over five years would total $2.3 billion. Assuming continuation of the automatic 1 percent match, this arrangement would remain superior to the coverage typically offered in the private sector.

There are several drawbacks to restricting the matching contributions. Part of TSP's appeal derives from the fact that it provides individual accounts for each participant, the value of which cannot be eroded by subsequent changes in law. This security and portability of TSP was a major reason behind the decision of many employees to switch to FERS, whose defined benefit plan was inferior to that of CSRS. Changing the TSP provisions would be especially unfair to this group, whose decision to switch plans quite reasonably assumed that changes would not be made. Opponents of restricting the match rate also argue that this will diminish employees' savings for retirement, and this problem would be intensified if the cut reduced participation.

Increase Employee Contributions Under the Civil Service Retirement System. As an alternative to cutting benefits, the government could reduce its retirement costs by increasing employee contributions. Currently, workers covered by CSRS contribute 7 percent of their salaries to their retirement fund. The employing agency contributes another 7 percent, and the federal government makes other contributions that are worth about 40 percent of payroll. Just over one-fifth of these payments are made by the U.S. Postal Service.

According to the Office of Personnel Management, these contributions, along with related interest earnings, will cover only about 90 percent of the cost of expected benefits. Raising the CSRS contribution rate to 9 percent over two years would alleviate this shortfall. This option would permanently increase the rates of contribution by 1 percentage point in January 1995 and by another point a year later. This option would generate revenue of about $4.2 billion through 1999.

The downside of increasing withholdings is that it threatens the government's ability to retain the experienced work force covered by CSRS. For those affected, the option is the equivalent of a 2 percent pay cut. It would also represent a reduction in the take-home salaries of CSRS employees, but

not for FERS employees, raising equity and morale issues. The change also penalizes workers who chose to stay in CSRS in 1987 rather than join the new FERS. More CSRS-covered employees would have switched to FERS when they had the opportunity if they had known that their contribution rate would be increased. While CSRS-covered employees contribute 7 percent of their salary for these benefits, private-sector employees contribute 6.2 percent of pay (up to $60,600) for Social Security, and according to recent survey data, only about 13 percent of private pension plans require additional employee contributions. Alternatively, the CSRS shortfall could be funded through higher agency contributions, even though this would not reduce the long-term cost to the taxpayers.

Raise the Retirement Age. The federal system generally permits retirement earlier than the private sector. Civilian employees can retire with immediate unreduced benefits at age 55 with 30 years of service, at 62 with 20 years of service, and at 65 with five years of service. As life expectancies have increased, Social Security and other retirement plans have raised retirement ages. Raising the retirement age would reduce federal retirement costs substantially. A number of options would reduce the generosity of federal retirement in the long run. Most savings, however, would occur far beyond the five-year savings period identified in this report, because such a reform would necessarily need to be phased in over several years.

ENT-42 END OR SCALE BACK TRADE ADJUSTMENT ASSISTANCE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
	End Trade Adjustment Assistance					
Budget Authority	220	220	200	210	210	1,060
Outlays	170	200	200	210	210	990
	Eliminate Trade Adjustment Assistance Cash Benefits					
Budget Authority	140	130	130	130	130	660
Outlays	140	130	130	130	130	660

The Trade Adjustment Assistance (TAA) program offers income-replacement benefits, training, and related services to workers unemployed as a result of import competition. To obtain assistance, such workers must petition the Secretary of Labor for certification and then meet other eligibility requirements. Cash benefits are available to certified workers receiving training, but only after their unemployment insurance benefits are exhausted.

Ending the TAA program would reduce federal outlays by $170 million in 1995 and by $990 million during the 1995-1999 period. Affected workers could apply for benefits under Title III of the Job Training Partnership Act (JTPA), which authorizes a broad range of employment and training services for displaced workers regardless of the cause of their job loss. Given that funding for Title III is limited, however, another alternative would be to eliminate only TAA cash benefits and shift the remaining TAA funds for training and related services to Title III. Savings under this option would total $660 million during the 1995-1999 period.

The rationale for these options is to secure under federal programs more equivalent treatment of workers who are permanently displaced as a result of changing economic conditions. Since Title III of JTPA provides cash benefits only under limited circumstances, workers who lose jobs because of foreign competition are now treated more generously than workers who are displaced for other reasons.

Eliminating TAA cash benefits would, however, cause economic hardship for some of the long-term unemployed who would have received them. In addition, TAA now compensates some of the workers adversely affected by changes in trade policy. Some argue, therefore, that eliminating TAA benefits could lessen political support for free trade, which economists generally view as beneficial to the overall economy.

ENT-43 INCREASE TARGETING OF CHILD NUTRITION SUBSIDIES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	300	630	710	750	800	3,190
Outlays	250	580	700	750	790	3,070

Federal child nutrition programs were developed to improve the health and well-being of children by providing them with nutritious meals. The programs provide cash and commodity assistance to schools, child care centers, and family day care homes that serve meals to children.

Although most of the funds are earmarked for low-income children, some of the aid benefits middle- and upper-income children as well. For example, in the National School Lunch Program (the largest of the child nutrition programs), most schools receive $1.73 in cash reimbursement for each meal served to children from households with incomes at or below 133 percent of the poverty line; a smaller subsidy of $1.33 for each meal served to children from households with incomes from 131 percent to 185 percent of poverty; and a subsidy of 17 cents a meal for children with household incomes above 185 percent of poverty. Schools are also given 14 cents' worth of commodities for each lunch served, regardless of the household income of the child. Comparable reimbursement structures are used in the School Breakfast Program and in the portion of the Child Care Food Program devoted to child care centers. Reimbursements to family day care homes do not vary with the household income of the child.

This option would make three changes. Cash and commodity subsidies for school lunches served to children with incomes above 350 percent of the poverty level would be eliminated. Subsidies for meals served to children in family day care homes would be reduced by 20 cents for snacks, 30 cents for breakfasts, and 40 cents for lunches unless the family day care provider determines that the children are from families with incomes at or below 185 percent of the poverty level. And school lunch subsidies for children from families with incomes from 131 percent to 185 percent of the poverty level would be increased by 20 cents.

Together, these changes would reduce federal expenditures by $3.1 billion during the 1995-1999 period. Eliminating the cash and commodity subsidies for all lunches served to children from households with incomes above 350 percent of the poverty line ($50,225 per year for a family of four in 1993) would reduce federal expenditures by $60 million in 1995, by $440 million in 1996, and by $2.2 billion during the 1995-1999 period. (These estimates assume that the changes would be effective on July 1, 1995, except for the change in subsidies to family day care homes, which would have an October 1, 1994, effective date.) Reducing the subsidies for the children in family day care homes would lower federal expenditures by $200 million in 1995 and by $1.4 billion during the 1995-1999 period. The higher subsidies called for in the third part of the option would increase federal expenditures by $500 million during the five-year period.

In these estimates, the Congressional Budget Office assumes that the reduction in federal subsidies would lead a small number of schools--those serving relatively few lunches to children from families with low incomes--to discontinue the program for all students. The savings resulting from schools dropping out of the program are an estimated $240 million over five years.

Although most of the federal funds are earmarked for low-income children, about one-fifth of the children who participate in the school lunch program have household incomes above 350 percent of the poverty line, and about three-quarters of the participating children in family day care homes have

household incomes above 185 percent of the poverty line. These children are less in need of federal subsidies, and the targeting of this assistance would be improved by limiting it to those from households with the lowest incomes. Increases in the subsidies for meals served to children in households with incomes from 131 percent to 185 percent of poverty would, in effect, redistribute some of the child nutrition subsidies from higher-income students to this group.

Such changes would probably result in lower participation among nonpoor children because participation falls when prices are raised. Participating schools would probably increase the price charged to nonpoor children to make up the loss in reimbursements unless state and local governments provided additional support. Children who dropped out of the program could receive meals of lower quality, since the meals qualifying for reimbursement are nutritionally adequate, whereas those from alternative sources might not be. Moreover, if the decline in participation were substantial, low-income children could become the main recipients of the meals and thus would be identifiable as poor by their peers. Finally, a few schools where nonpoor children provide a large share of the total revenue for the meal program would probably drop out when participation fell, thereby eliminating federally subsidized meals for the low-income children attending them.

ENT-44 ELIMINATE SMALL FOOD STAMP BENEFITS

Savings from CBO Baseline	1995	1996	1997	1998	1999	Cumulative Five-Year Savings
	Annual Savings (Millions of dollars)					
Budget Authority	60	60	60	60	60	300
Outlays	60	60	60	60	60	300

The Food Stamp program provides coupons that enable low-income householders to buy a low-cost but nutritionally adequate diet. Among all programs providing assistance to low-income people, its reach is the greatest, encompassing all types of households, from the elderly living alone to two-parent families with children.

Because the benefits to which a household is entitled decline as its income rises, some households can receive only small amounts of food coupons each month. For one- and two-person households, a special rule increases the food coupons they receive to $10 a month even if their net income indicates a smaller coupon amount.

This option would eliminate the special rule that ensures a $10 minimum benefit for eligible households with one or two persons, and would also eliminate any food stamp benefits of less than $10 a month for all households, thereby reducing federal expenditures by $60 million in 1995 and by $300 million during the 1995-1999 period. These savings include an estimated $8 million a year from lower administrative costs. Approximately 400,000 households, two-thirds of which are composed of elderly people, would lose their food stamp benefits.

Carrying out this option would make administering the Food Stamp program more cost-effective because a large number of households that receive small monthly benefits would no longer have to be served. It would also eliminate the special treatment of one- and two-person households. Finally, such a change would foster consistency between the Food Stamp program and the Aid to Families with Dependent Children program, which has not paid benefits of less than $10 a month for the past decade.

At the same time, this option would reduce by as much as $120 a year the effective incomes of households in which incomes are already low. Even though the households that would be affected are those with the highest incomes among food stamp recipients, their incomes are usually close to the poverty threshold.

ENT-45 REDUCE THE $20 EXCLUSION FROM INCOME IN SUPPLEMENTAL SECURITY INCOME

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	180	190	200	210	220	1,000
Outlays	180	190	200	210	220	1,000

The Supplemental Security Income (SSI) program provides federally funded monthly cash payments, based on uniform, nationwide eligibility rules, to needy aged, blind, or severely disabled people. As a means-tested program, SSI's benefits are reduced by recipients' outside incomes, subject to certain exclusions. For unearned income, most of it from Social Security payments, the first $20 a month is excluded and any additional amounts reduce benefits dollar for dollar. Earned income is excluded more liberally, and any of the $20 exclusion not applied to unearned income is applied to earned income.

Reducing the $20 exclusion to $15 would save $180 million in 1995 and $1 billion over the 1995-1999 period. A program that ensures a minimum living standard for its recipients need not provide a higher standard for people who happen to have unearned income, as illustrated by the absence of any standard exclusions for unearned income (other than child support) in the Aid to Families with Dependent Children program.

Nevertheless, reducing the $20 exclusion would decrease by as much as $60 a year the incomes of the roughly 2.6 million low-income people--almost 50 percent of all federal SSI recipients--who now benefit from the exclusion. Even with the full $20 exclusion, incomes of most SSI recipients fall below the poverty threshold.

ENT-46 ELIMINATE THE $50 CHILD SUPPORT PAYMENT TO AFDC FAMILIES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	110	120	130	130	140	630
Outlays	110	120	130	130	140	630

The Child Support Enforcement program collects child support payments from absent parents on behalf of families receiving Aid to Families with Dependent Children (AFDC). These payments are largely used to offset federal and state costs for AFDC. Amounts up to the first $50 in monthly child support collected, however, are paid to the AFDC family, with no effect on the level of AFDC benefits. In essence, this policy means that AFDC families for whom absent parents contribute child support get as much as $50 more a month than do otherwise identical families for whom such contributions are not made.

Eliminating the $50 child support payment to AFDC families would save the federal government $110 million in fiscal year 1995 and $630 million through 1999. Stopping such payments would end the differential treatment of AFDC families that depends on whether the absent parent pays child support. Administrative complexity would also be reduced.

Nevertheless, the child support payment continues to provide incentives for custodial parents to make an effort to obtain support. If the payment were eliminated, recipients of Aid to Families with Dependent Children could be no better off when absent parents paid child support than when they did not, perhaps reducing recipients' cooperation in seeking such payments. Absent parents also might reduce their child support payments if this option were enacted, although new enforcement tools such as the withholding of wages would make it difficult for many to do so. In either case, the well-being of the children in these families would be adversely affected.

ENT-47 REDUCE THE FEDERAL MATCHING RATE AND INCREASE FEES IN THE CHILD SUPPORT ENFORCEMENT PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
		Reduce the Federal Matching Rate				
Budget Authority	a	540	590	650	690	2,470
Outlays	a	540	590	650	690	2,470
		Charge Fees for Services				
Budget Authority	a	60	60	70	80	270
Outlays	a	60	60	70	80	270

NOTE: These estimates do not take into consideration the interaction between the two options, which is noted in the discussion.

a. The options would not take effect until 1996.

Enacted in 1975, the Child Support Enforcement (CSE) program provides administrative tools and funding that states can use to improve the payment of child support by absent parents. The federal government helps states finance their CSE efforts by paying 66 percent of the costs and making incentive payments. Because of this federal funding and because they keep a portion of child support collections, states saved $435 million in 1992. By contrast, the federal government incurred costs in 1992 of about $605 million, after accounting for its share of child support collections.

To improve the performance of the program, the Family Support Act of 1988 required several complex changes in child support practices, some of which need not be carried out until 1994 and 1995. In order to allow sufficient time for states and localities to put these changes into place without disruption, the options presented here would not take effect until 1996.

Reduce the Federal Matching Rate. Lowering the federal matching rate from 66 percent to 50 percent in 1996 and subsequent years is estimated to save $540 million in 1996 and $2.5 billion through 1999, although the amount of savings could vary, depending on how states reacted to the change.

Reducing the federal share of CSE costs would alter the balance of costs and savings between the federal and state governments, decreasing both federal costs and state savings. Although a higher matching rate may have been needed in the past to induce states to set up CSE programs, such programs are now operating and cannot be dismantled without financial penalty. Even with a 50 percent matching rate, states would continue to save money. Finally, this option would encourage states to improve the efficiency of their CSE efforts, since they would pay a larger share of the costs of inefficiencies, and could thus lead to even lower program costs overall.

Lowering the matching rate would entail some risks, however. Because caseloads per child support worker are already high, it is unlikely that states could improve efficiency enough to offset fully the reduction in federal payments. Thus, they might cut CSE services, thereby reducing child support collections. The lower CSE collections for AFDC families would decrease state revenues from that source, but some states still might be better off financially if they cut CSE services, since those with low per capita incomes may receive only a small share--as low as 21 percent--of child support collected. Further, states receive only small financial benefits

from child support collections for non-AFDC families. They might, therefore, be even more likely to cut back on efforts for those families, thereby lowering the children's living standards.

Charge Fees to Some Families. Although states are required to charge application fees for furnishing child support services to non-AFDC families, many states charge only nominal amounts. In 1993, child support enforcement agencies collected fees amounting to $31 million, or less than 2 percent of total program costs. This option would require states to charge non-AFDC families fees of $25 at the time they applied for services and $25 each year in which child support was collected for them. Some flexibility could be given to states by allowing them to charge the annual user fee to either the custodial parent or the absent parent, to exempt low-income families but charge more to higher-income families, or to pay the fee directly to the federal government without charging families.

If the fee requirement were imposed beginning in 1996, the federal government would save $60 million that year and $270 million through 1999, at the current 66 percent federal matching rate. With a matching rate of 50 percent, as discussed above, savings would decline to $40 million in 1996 and $190 million through 1999.

Considering the substantial services many families receive from the child support enforcement agencies, these fees would be a modest contribution toward meeting their costs. Charging fees could discourage some custodial parents from seeking assistance, however, potentially reducing collections of child support. The families most likely to be discouraged would probably be those most in need of the income, unless states chose to exempt low-income families from paying the fees. In addition, states have often complained about the costs of collecting fees, particularly when they do not have adequate computerized systems. Under those circumstances, it is particularly desirable to delay the effective date for any fee requirements until after the enhanced automated systems required by the Family Support Act are in place.

ENT-48 REDUCE THE REPLACEMENT RATE WITHIN EACH BRACKET OF THE SOCIAL SECURITY BENEFIT FORMULA

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Outlays	130	530	1,130	1,860	2,690	6,340

NOTE: Reductions in Social Security spending or increases in Social Security taxes would reduce the total federal deficit and the amount of federal borrowing from the public. These savings would not be counted, however, under the pay-as-you-go provisions of the Budget Enforcement Act of 1990.

Under current law, the basic Social Security benefit is determined by a formula that provides workers with 90 percent of their average indexed monthly earnings (AIME) up to the first bend point (which defines the first earnings bracket), plus 32 percent of the AIME in the second bracket, plus 15 percent of the AIME above the second bend point. One method of reducing initial Social Security benefits would be to lower these three rates by a uniform percentage.

Lowering the three rates in the benefit formula from 90, 32, and 15 percent to 87.3, 31.0, and 14.6 percent, respectively, would achieve an essentially uniform 3 percent reduction in the benefits of newly eligible workers starting in 1995. Thus, a 62-year-old retiree who has always earned the average wage would receive initial benefits in 1995 of about 34 percent of preretirement earnings, compared with 35 percent if no change were made.

This reduction in the replacement rates would lower Social Security outlays by about $6.3 billion over the 1995-1999 period and by more in later years. Moreover, this option would reduce the benefits of all future retirees by essentially the same percentage. Furthermore, the option could be combined with a one-time cut in the cost-of-living adjustment to ensure that benefits for both current and future recipients would be reduced to a similar extent (see ENT-56). The combination would generate substantial budgetary savings, while having a relatively small impact on both current and future beneficiaries.

Opponents contend that the Social Security Amendments of 1983 have already sharply reduced the benefits of future retirees and that further reductions would be unfair. In particular, the age at which unreduced Social Security retirement benefits are first available will rise in stages from 65 to 67 for workers turning 62 between the years 2000 and 2022. As a consequence, benefits for workers retiring after the turn of the century will be less than what would have been received had the full retirement age not been increased. For example, a worker who retires at age 62 in 2022 will receive 70 percent of the primary insurance amount, compared with 80 percent for a worker who retired at age 62 in 1994.

An alternative method of reducing Social Security benefits would leave replacement rates unchanged but narrow the AIME brackets over which those rates apply, perhaps by reducing the pace at which the brackets are indexed for inflation. This approach would exempt beneficiaries with the lowest AIMEs from the cut, but would impose benefit reductions unevenly among other recipients.

ENT-49 ELIMINATE SOCIAL SECURITY BENEFITS FOR CHILDREN OF RETIREES AGES 62-64

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Outlays	80	240	410	500	500	1,730

NOTE: Reductions in Social Security spending or increases in Social Security taxes would reduce the total federal deficit and the amount of federal borrowing from the public. These savings would not be counted, however, under the pay-as-you-go provisions of the Budget Enforcement Act of 1990.

Unmarried children of retired workers are eligible for Social Security benefits as long as they are under age 18, or attend elementary or secondary school and are under age 19, or become disabled before age 22. A child's benefit is equal to one-half of the parent's basic benefit, subject to a dollar limit on the maximum amount receivable by any one family. If such benefits were eliminated for the children of retirees ages 62 through 64, beginning with retirees reaching 62 in October 1994, the savings would total $1.7 billion over the next five years.

This option might encourage some early retirees to stay in the labor force longer. At present, though benefits for retired workers and their spouses are actuarially reduced if retirement occurs before age 65, children's benefits are not. Further, the younger the workers are, the more likely they are to have children under 18. Thus, workers under 65 now have an incentive to retire while their children are still eligible for benefits. This incentive is quite small, however, for families in which spouses are also entitled to dependents' benefits. For these families, the increase in total benefits attributable to all eligible children cannot exceed 38 percent of the worker's primary insurance amount.

However, for families with workers whose retirement was not voluntary--because of poor health or unemployment, for example--the loss in family income might cause some hardship. Moreover, since spouses under 62 receive benefits only if their children under age 16 also receive benefits, eliminating children's benefits for families of early retirees would also result in the loss of entire benefits for spouses in some families. In such cases, the total loss of income would generally be large.

A different approach would apply the same actuarial reduction to children's benefits that is applied to the benefits of the worker on whom those benefits depend. Thus, for example, the child of a worker retiring at age 62 would receive a maximum of 40 percent of the parent's basic benefit, instead of the 50 percent that is currently allowed. Such an approach would avoid large losses in benefits for workers with young children, but would save less.

ENT-50 LENGTHEN THE SOCIAL SECURITY BENEFIT COMPUTATION PERIOD BY THREE YEARS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Outlays	40	190	480	930	1,500	3,140

NOTE: Reductions in Social Security spending or increases in Social Security taxes would reduce the total federal deficit and the amount of federal borrowing from the public. These savings would not be counted, however, under the pay-as-you-go provisions of the Budget Enforcement Act of 1990.

Social Security retirement benefits are based on the average indexed monthly earnings (AIME) of workers in employment covered by the system. The present formula computes AIME based on workers' best 35 years of employment. Lengthening the averaging period would generally lower benefits slightly by requiring more years of lower earnings to be factored into the benefit computation. This option would increase the AIME computation period gradually until it reached 38 years for people turning age 62 in 1997 or beyond. This approach would save $3.1 billion over the next five years and more in later years.

One argument for a longer computation period is that people are now living longer and the normal retirement age for the Social Security program will be raised beginning in the year 2000. Using more years to calculate the AIME would reduce incentives for early retirement. In addition, lengthening the averaging period would reduce the advantage that workers who postpone entering the labor force have over those who get jobs at younger ages. Because many years of low or no earnings can be ignored in calculating AIME, the former group currently experiences little or no loss of benefits for its additional years spent not working and thus not paying Social Security taxes.

Because some beneficiaries elect early retirement for such reasons as poor health or unemployment, an argument against this proposal is that a longer computation period would reduce benefits for recipients who are least able to continue working. Other workers who would be disproportionately affected include those with significant periods outside the Social Security system, such as parents--usually women--who interrupted their careers to rear children, and workers who experienced long periods of unemployment or employment not covered by Social Security.

ENT-51 CONSIDER VETERANS' COMPENSATION WHEN DETERMINING SOCIAL SECURITY DISABILITY INCOME PAYMENTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
			Coordinate Benefits for All Veterans Receiving Compensation			
Outlays	75	105	115	125	135	555
			Coordinate Benefits for Veterans Newly Awarded Compensation			
Outlays	10	20	30	45	55	160

People with disabilities may qualify for cash payments from more than one source, including the Social Security Disability Insurance (DI) program, veterans' compensation, workers' compensation, means-tested programs like the Supplemental Security Income program, and private disability insurance. If they are younger than 65 and covered under Social Security, workers who are unable to work because they are physically or mentally impaired may qualify for DI payments.

When Social Security beneficiaries are eligible for multiple disability benefits, ceiling arrangements limit combined public disability benefits to 80 percent of the workers' average earnings before they were disabled. The combined payment after the reduction is adjusted periodically for changes in the cost of living and in national average wage levels. Veterans' compensation payments for disabilities, however--as well as means-tested benefits and benefits based on public employment covered by Social Security--are not included when applying the ceiling.

Approximately 2.2 million veterans--about 1.2 million of whom are under age 65--receive compensation for service-connected disabilities. The amount of compensation is based on a rating of an impairment's average effect on a person's ability to earn wages in civilian occupations. Additional allowances are paid to veterans whose disabilities are rated 30 percent or higher and who have dependent spouses, children, or parents An estimated 125,000 veterans who receive compensation also receive DI payments from the Social Security program.

This option, which has two variations, would include veterans' compensation within the scope of the ceiling. (The combined payment, however, would never be less than either the DI benefit or the veterans' compensation payment.) Under both versions, compensation would be totaled when determining how much the DI benefit of an individual under 65 would be reduced to keep the combined benefit from exceeding the ceiling. One version of the option would apply this change to all current and future recipients of veterans' disability compensation. The other version would limit application of the option to veterans newly qualifying for disability compensation in the future.

Applying the change to both current and future recipients of veterans' compensation would affect an estimated 30,000 recipients in 1995 and would save an estimated $555 million over the 1995-1999 period. Applying the change only to veterans newly awarded compensation payments in the future would affect an estimated 15,000 recipients by 1999 and would save an estimated $160 million over the 1995-1999 period.

Implementing these options would mean that an explicit policy would determine the total amount of

public compensation for veterans with service-connected disabilities. Thus, the federal government would treat in a more consistent way people who receive cash disability payments from multiple programs that are not means-tested. Both versions of the option could, however, be seen as subjecting veterans' compensation benefits to a form of income testing. Moreover, under the variation of this option that would apply to current recipients of disability compensation, the incomes of some disabled veterans would drop.

ENT-52 END VETERANS' DISABILITY AND DEATH COMPENSATION AWARDS IN FUTURE CASES WHEN A DISABILITY IS UNRELATED TO MILITARY DUTIES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	20	80	180	290	420	990
Outlays	20	70	170	280	410	950

Veterans are eligible for disability compensation if they either receive or aggravate disabilities during active military service. Service-connected disabilities are currently defined as those resulting from diseases, injuries, or other physical or mental impairments that occurred or were intensified during military service, excluding those resulting from willful misconduct. Disabilities need not be incurred or made worse while performing military duties to be considered service-connected; for example, disabilities incurred while on leave also qualify.

A 1989 survey by the Department of Veterans Affairs (VA) suggests that about 50 percent of veterans receiving compensation payments were being compensated for injuries or diseases not related to the performance of military duties, and the relationship to military duties was uncertain for an additional 5 percent. Federal outlays could be reduced by $950 million during the 1995-1999 period by ending disability and death compensation awards in future cases in which a disability is neither incurred nor aggravated while performing military duties. Doing so would make disability compensation of military personnel comparable with disability compensation of federal civilian employees under workers' compensation arrangements.

In both cases, diseases, injuries, or impairments unrelated to employment tasks would not entitle a person to compensation. The VA's formal appeals system could be extended to cover rulings specifying that disabling conditions were unrelated to military duties. Because military personnel are assigned to places where situations may sometimes be volatile, however, they have less control than civilians over where they spend their off-duty hours. Moreover, it may often be difficult to determine whether a veteran's disease, injury, or impairment was entirely unrelated to military duties.

Data from sources other than the 1989 VA survey indicate that about 250,000 veterans currently receive VA compensation payments totalling $1.5 billion a year for diseases that the General Accounting Office (GAO) reports are generally neither caused nor aggravated by military service. The diseases include arteriosclerotic heart disease, diabetes mellitus, multiple sclerosis, Hodgkins disease, chronic obstructive pulmonary disease (including chronic bronchitis and pulmonary emphysema), hemorrhoids, schizophrenia, osteoarthritis, and benign prostatic hypertrophy. Ending new awards for veterans with these diseases would have a more limited impact because it would not affect all veterans whose compensable disabilities are not connected with military service. It could, however, eliminate compensation for some veterans whose disabilities the GAO finds are not generally service-connected but whose circumstances constitute an exception from this general conclusion. This approach would yield smaller savings than the previous measure--about $620 million over the 1995-1999 period.

ENT-53 END VETERANS' COMPENSATION PAYMENTS FOR CERTAIN VETERANS WITH LOW-RATED DISABILITIES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Budget Authority	640	650	660	670	690	3,310
Outlays	640	600	660	670	680	3,250

Approximately 2.2 million veterans with service-connected disabilities receive veterans' disability compensation benefits. The amount of compensation is based on a rating of the individual's impairment that is intended to reflect an average reduction in the ability to earn wages in civilian occupations. Demonstrated loss of income, however, is not a requirement for eligibility. Veterans' disability ratings range from zero to 100 percent (most severe). Veterans unable to maintain gainful employment who have ratings of at least 60 percent are eligible to be paid at the 100 percent disability rate. Additional allowances are paid to veterans who have disabilities rated 30 percent or higher and who have dependent spouses, children, or parents. Receiving veterans' disability compensation does not affect the level of Social Security disability benefits to which an individual may be entitled (see ENT-51).

Currently, 1.3 million veterans have disability ratings below 30 percent and receive benefits of between $70 and $166 a month. Federal outlays could be reduced by $3.3 billion during the 1995-1999 period by ending disability benefits for low-rated disabilities, except for veterans with moderate or low family incomes. The income threshold used for this illustration is the median income of all families, which was about $37,000 in 1992. Thresholds that varied by family size would be a better measure of need, but the necessary information about the size of the families of the veterans who would be affected by this option was not available. (See ENT-57 for options to restrict eligibility for most non-means-tested entitlement programs, including veterans' compensation, on the basis of family income.)

Eliminating compensation benefits for veterans with disability allowances below 30 percent and relatively high family incomes would concentrate spending on the most impaired veterans. Because performance in civilian jobs depends less now on physical labor than when the disability ratings were originally set, and because improved reconstructive and rehabilitative techniques are now available, physical impairments rated below 30 percent may not reduce veterans' earnings. Low-rated disabilities include conditions such as mild arthritis, moderately flat feet, or amputation of part of a finger--conditions that would not affect the ability of veterans to work in many occupations today.

Veterans' compensation could be viewed, however, as career or lifetime indemnity payments owed to veterans disabled to any degree while serving in the armed forces, regardless of family income. Moreover, some disabled veterans--especially older ones who have retired--might find it difficult to increase their working hours or otherwise make up the loss in compensation payments.

ENT-54 ELIMINATE "SUNSET" DATES ON CERTAIN PROVISIONS FOR VETERANS IN THE OMNIBUS BUDGET RECONCILIATION ACT OF 1993

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Reduce Pensions to Medicaid Nursing Home Residents						
Budget Authority	0	0	0	0	190	190
Outlays	0	0	0	0	190	190
Verify Income Reported for Pension Purposes						
Budget Authority	0	0	0	0	25	25
Outlays	0	0	0	0	25	25
Recover Certain Medical Care Costs for Veterans from Third Parties						
Budget Authority	0	0	0	0	240	240
Outlays	0	0	0	0	240	240
Impose Copayments for VA Medical Care						
Budget Authority	0	0	0	0	90	90
Outlays	0	0	0	0	90	90
Eliminate All Sunset Dates						
Budget Authority	0	0	0	0	545	545
Outlays	0	0	0	0	545	545

Four provisions in laws affecting veterans contain "sunset dates"--dates when the provisions cease to apply. As a result, starting in 1999, outlays will be higher than if the provisions remained in effect. These provisions have:

- Limited to $90 the monthly benefit for certain pensioners without dependents who are eligible for Medicaid coverage for nursing home care (expires September 30, 1998);
- Authorized the Internal Revenue Service to help the Department of Veterans Affairs (VA) verify incomes reported by beneficiaries, for the purpose of establishing eligibility for pensions and benefits (expires September 30, 1998);
- Authorized the VA to collect from any health insurer that contracts to insure a veteran with service-connected disabilities the reasonable cost of medical care provided by the VA for the treatment of non-service-connected disabilities (expires September 30, 1998); and
- Authorized the VA to charge copayments to certain veterans receiving inpatient and outpatient care and outpatient medication from agency facilities (expires September 30, 1998).

This option would make the effects of these provisions permanent by eliminating the sunset date in each case. If all four provisions were made permanent, savings during the 1995-1999 period would total about $0.5 billion.

The main advantage of this option is that it would convert the temporary savings achieved by these provisions into continuing savings. The main disadvantage of the option is that certain veterans or their insurers would be worse off financially.

ENT-55 CHARGE A PENALTY FOR EARLY REDEMPTIONS OF SAVINGS BONDS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Outlays	15	40	55	60	70	240

In normal times, the Treasury Department sells almost $1 billion a month in savings bonds to investors. Bonds are sold for prices as low as $25. No investor can buy more than $15,000 worth in a year. Savings bonds pale next to the Treasury's chief sources of borrowed funds (bills, notes, and bonds sold at auction), but nevertheless represent a significant pool of money.

The Treasury has authority to design the key features of savings bonds, but is required by law to pay a 4 percent minimum rate. Since 1982, the Treasury has offered market-based savings bonds. If held for five years, these return 85 percent of the market yield on five-year Treasury securities over the bonds' lifetime, a yield that the Treasury Department updates semi-annually. Under the Congressional Budget Office's interest rate assumptions, today's buyers are expected to realize a rate of slightly more than 4 percent in five years--a return that will automatically follow market rates if they move up.

But the 4 percent floor also applies to short-term investors. It exceeds the rate now paid on instruments such as money market funds or short-term certificates of deposit, which is about 3 percent. There does not appear to be a widespread response to the resulting temptation to substitute savings bonds for other short-term investments. The maximum gain for any individual saver is automatically restricted, because investors cannot buy more than $15,000 worth of bonds a year. Most buyers do, in fact, hold the bonds for five years (or more).

Nevertheless, it might be desirable to design savings bonds so that they would be wholly unappealing to investors with short-term horizons. One way to do so would be to charge an interest penalty for early redemption. The minority of holders who redeem their bonds before the fifth anniversary could be charged a six-month interest penalty. This change would require a repeal of the 4 percent statutory minimum interest rate and a clear signal--either in the legislation itself or in a public announcement by the Treasury--that short-term holders would henceforth be paid a lower rate of interest. CBO's estimates of the budgetary savings assume that the change, if adopted, would be effective for bonds sold beginning in October 1994.

This option would hit the shortest-term investors hardest; it would wipe out much or most interest for anyone who held a savings bond for a short period (such as one year or less), but would be proportionately smaller for someone who redeemed a bond after, say, four and one-half years. Furthermore, such a penalty would implicitly recoup some of the relatively high transaction costs of savings bond issuance and redemption. Similar penalties are widespread in the private sector; CBO's informal survey of financial institutions offering five-year certificates of deposit revealed that all charged penalties for premature withdrawal and that the forfeiture of six months' interest was the single most common penalty. This change would, of course, reduce the interest income of a minority of savings bond purchasers, including some who may have planned to hold their bonds for five years but found that they needed cash sooner.

The Treasury Department administers the savings bond program by sending tables of redemption values to thousands of paying agents. It might carry out this change by cutting back redemption values for all new bonds until they are five years old (just as it carried out the most recent cutback in the guaranteed rate, from 6 percent to 4 percent, by promulgating new redemption tables in March 1993). Because interest on savings bonds is defined in the budget simply as the change in the bonds'

redemption value, such a step could superficially generate greater budgetary savings than depicted above. However, only a minority of bondholders would actually collect diminished interest. Any putative savings attributable to other buyers--the majority who do hold their bonds for five years--would not be genuine savings but would stem purely from the Treasury's accounting conventions, and would thus be omitted from CBO's estimate.

ENT-56 RESTRICT COST-OF-LIVING ADJUSTMENTS IN NON-MEANS-TESTED BENEFIT PROGRAMS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
Eliminate COLAs for One Year						
Social Security/ Railroad Retirement	7,400	10,000	10,150	10,200	10,200	47,950
Other Non-Means-Tested Programs	900	2,400	2,400	2,450	2,600	10,750
Offsets in Means-Tested Programs and Medicare Premiums	-1,650	-850	-500	-450	-400	-3,850
Total	6,650	11,550	12,050	12,200	12,400	54,850
Limit COLAs to Two-Thirds of the CPI Increase for Five Years						
Social Security/ Railroad Retirement	2,450	5,800	9,500	13,400	17,500	48,650
Other Non-Means-Tested Programs	300	1,100	2,050	2,900	4,200	10,550
Offsets in Means-Tested Programs and Medicare Premiums	-100	-200	-500	-750	-1,000	-2,550
Total	2,650	6,700	11,050	15,550	20,700	56,650
Limit COLAs to the CPI Increase Minus 2 Percentage Points for Five Years						
Social Security/ Railroad Retirement	4,900	11,750	18,900	26,300	33,900	95,750
Other Non-Means-Tested Programs	600	2,250	4,050	5,700	8,150	20,750
Offsets in Means-Tested Programs and Medicare Premiums	-300	-500	-1,500	-2,400	-2,400	-7,100
Total	5,200	13,500	21,450	29,600	35,650	109,400
Pay the Full COLA on Benefits Below a Certain Level and 50 Percent of the COLA on Benefits Exceeding That Level for Five Years						
Social Security/ Railroad Retirement	0	1,050	2,500	4,100	5,700	13,350

NOTE: Reductions in Social Security spending or increases in Social Security taxes would reduce the total federal deficit and the amount of federal

Under current policies, outlays for Social Security and other non-means-tested cash transfer programs whose benefits are indexed to the consumer price index (CPI) are expected to total $390 billion in 1995 and to rise to $470 billion by 1999. Reducing the automatic cost-of-living adjustment (COLA) for these programs is commonly proposed as one way to slow the growth in entitlement spending. Four strategies for reducing COLAs and the savings in outlays resulting from each are shown in the preceding table. The programs in which COLAs would be reduced under the first three options are Social Security Old-Age, Survivors, and Disability Insurance, Railroad Retirement, Civil Service Retirement, Military Retirement, federal employees' workers' compensation, veterans' benefits, and retirement benefits for the Foreign Service, the Public Health Service, and the Coast Guard. The fourth option would affect only Social Security and Railroad Retirement Tier I COLAs. (Other options for achieving savings in Social Security are given in ENT-48, ENT-49, ENT-50, ENT-51, and REV-12.)

COLA restrictions would achieve considerable savings by exacting small reductions in benefits from a large number of people, in contrast to other budget options that would impose large reductions in benefits on smaller groups of recipients. Moreover, limiting these options to the non-means-tested cash benefit programs would protect many of the poorest beneficiaries of entitlements--for example, recipients of Supplemental Security Income--from losses of income. Finally, because the benefit levels would be permanently lowered for those eligible when the COLA limitation was established, significant reductions in outlays would persist beyond the five-year projection period. The savings would eventually disappear, however, as beneficiaries died or stopped receiving payments for other reasons, unless the COLA limitation was accompanied by a permanent reduction in the initial benefits of newly eligible workers (see ENT-48).

Budget reduction strategies that institute less-than-complete price indexing would, however, result in financial difficulties for some recipients--particularly if COLAs were restricted for an extended period. Restrictions on COLAs also encounter opposition from those who fear that changes made to reduce budget deficits would undermine the entire structure of retirement income policy. For example, because private pension plans generally do not offer complete indexing, restricting Social Security COLAs would further reduce protection for beneficiaries against inflation. Some people also think that, because Social Security and other retirement programs represent long-term commitments to both current retirees and today's workers, these programs should be altered only gradually and then only for programmatic reasons. According to this view, any changes in benefits should be announced well in advance to allow people to adjust their long-run plans.

Unless restrictions on COLAs were accompanied by commensurate changes in determining initial benefits for new recipients, disparities in benefit levels would develop among different cohorts of retirees. This situation is particularly relevant for Social Security, where benefits for newly eligible individuals are based on an indexed benefit formula and on indexed earnings histories. For example, if prices rose by 4 percent in a year and the wage index used to compute benefits for newly eligible recipients increased by 5 percent, eliminating that year's COLA without any change in the calculation of initial benefits would result in benefits for new beneficiaries that were about 5 percent higher than for recent retirees; under current law, benefits would be only about 1 percent higher for the new retirees. To alleviate this problem and to achieve additional savings, efforts to slow the growth in benefits through COLA limitations might be extended to the formulas for determining initial benefits (see ENT-48).

There are several options that would restrict COLAs for current beneficiaries. Except for the option to limit COLAs to 2 percentage points less than the increase in the CPI, the magnitude of the savings in each case--as well as the impact on beneficiaries--would be very sensitive to the level of inflation in the years in which the COLAs would be reduced. If prices were to rise faster than currently assumed, savings would be greater than shown, and recipients would bear larger costs. If prices were to rise less quickly, both budgetary savings and the effect on recipients would be smaller.

The following are specific versions of COLA restrictions.

Eliminate COLAs for One Year. One option would be to eliminate COLAs in fiscal year 1995 for non-means-tested benefit programs, while allowing them to be paid in subsequent years, but with no provision for making up the lost adjustment. If this approach were taken, federal outlays would be reduced by about $6.6 billion in 1995 and $54.9 billion over five years, with Social Security and Railroad Retirement accounting for most of the total.

Limit COLAs to Two-Thirds of the CPI Increase for Five Years. Under this approach, recipients would be compensated for only a certain proportion of inflation, such as two-thirds of the annual CPI increase. Under current economic assumptions by the Congressional Budget Office, applying this restriction for five years would save about $2.7 billion next year and $56.6 billion over the 1995-1999 period. As a result, benefits for people who received payments throughout the five-year period would be about 5 percent less in 1999 than they would have been under full price indexing. Furthermore, this option would reduce the real incomes of beneficiaries at the same time that they were becoming less able to supplement their incomes by working.

Limit COLAs to the CPI Increase Minus 2 Percentage Points for Five Years. An approach similar to the proportionate COLA reduction would be to reduce the adjustment by a fixed number of percentage points--for example, set the adjustment at the CPI increase minus 2 percentage points. Unlike other options to restrict COLAs, however, both savings and effects on beneficiaries would be roughly the same regardless of the level of inflation--about $109.4 billion over the next five years, if extended for the full period. As in the previous option, this approach would be cumulative and would therefore significantly reduce the real incomes of beneficiaries at the same time that their ability to supplement their incomes by working declined.

Pay the Full COLA on Benefits Below a Certain Level and 50 Percent of the COLA on Benefits Exceeding That Level for Five Years. Another alternative would tie the COLA reductions to beneficiaries' payment levels, starting in 1996. The example discussed here--based only on Social Security and Rai[illegible] Retirement Tier I benefits--would award the [illegible] for benefits based on the first $630 of a [illegible]s monthly primary insurance amount (PIA) and 50 percent of the COLA on benefits above this level. The $630 per month threshold is about equal to the projected 1996 poverty threshold for an elderly person and would be indexed to maintain its value over time.

This approach would save about $1.0 billion in 1996 and $13.3 billion over the 1996-1999 period. Because of the time needed to implement this proposal, these estimates assume that it would be in place by January 1996.

Because the full COLA would be paid to beneficiaries with low PIAs, this option would ensure that low-income recipients would not be adversely affected. Moreover, its percentage impact would be greater for recipients with higher benefits. Nonetheless, benefit levels are not always good indicators of total income. Some families with high benefits have little other income, while some with low benefits have substantial income from other sources. Furthermore, many people object to any changes in retirement programs that might be construed as introducing a means test for benefits, even if the test is limited only to the COLA.

A variation would extend this approach to the other non-means-tested benefit programs besides Social Security; this variation is not shown in the table. Such an option would spread the effects among a wider group of recipients, although it might be somewhat more complicated to design because the different benefit structure in each program could require a separate determination of the appropriate benefit levels on which to pay reduced COLAs.

Eliminating COLAs for recipients whose benefits are based on PIAs above a certain level is another option. Because this reduction would affect the entire benefit of each recipient above the threshold, not just the portion of the benefit above that level, both the savings and the impacts on beneficiaries would be considerably greater. Unless adjustments were made at the threshold, however, recipients with benefits just below the threshold could be made better off than those with benefits just above it. Still another approach that would address some of the administrative problems of these two options would involve increased taxation of Social Security benefits (see REV-12).

ENT-57 APPLY MEANS TESTS TO FEDERAL ENTITLEMENTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
	Make Entitlements Subject to Individual Income Tax					
Non-Means-Tested Entitlements	16,200	46,500	50,400	55,000	60,000	228,100
All Entitlements	18,400	53,400	58,300	63,800	69,600	263,500
	Reduce Entitlements Provided to Middle- and High-Income Families					
Non-Means-Tested Entitlements	10,100	47,500	44,100	46,800	49,800	198,300
All Entitlements	10,100	49,200	45,800	48,800	52,100	206,000
	Deny Entitlements to High-Income Recipients					
Non-Means-Tested Entitlements	4,300	10,500	9,600	10,300	11,000	45,700
All Entitlements	4,300	10,600	9,700	10,400	11,100	46,100

SOURCE: Congressional Budget Office

NOTE: Estimates do not include administrative costs or revenue losses from reductions in taxable benefits.

There are two basic approaches to the constraint of entitlement spending. One broad strategy would reduce the growth of spending (or tax the benefits at higher rates) on a program-by-program basis. New program rules or tax laws could limit who qualifies for benefits, reduce the amount of benefits provided, or change the taxation of benefits. (Examples of this kind of approach include ENT-40, ENT-48, ENT-50, ENT-53, ENT-56, REV-12, and REV-17.)

An alternative to the program-by-program approach would constrain entitlements as a group through some form of means-testing under which benefits would be cut most for beneficiaries with the highest incomes. Three illustrations of this method of constraining entitlements are discussed here. The first approach would subject most entitlement benefits to federal individual income taxes, the second approach would reduce benefits as beneficiaries' incomes rise, and the third approach would deny benefits to individuals with incomes above specified thresholds. The savings attributed to these three approaches would be smaller than shown here if the Congress enacted one or more of the program-by-program approaches described in other options.

Some federal entitlements are already subject to limits on income or wealth under program regulations. The federal part of Supplemental Security Income (SSI) is available only to elderly and disabled people with monthly incomes below federally specified national limits. Aid to Families with Dependent Children (AFDC) goes only to families with children who have monthly incomes below limits set by individual states. Recipients of SSI and AFDC

Only households with monthly incomes below the federal poverty guidelines qualify for food stamps. Because these and other means-tested programs currently provide benefits only to people with low monthly incomes, subjecting them to any of the three methods of means-testing discussed here would duplicate the current means-testing at significantly higher income levels, imposing administrative and compliance costs with little effect on net saving. At the same time, because each of the alternative approaches would impose an annual means test--as opposed to the monthly tests now used in each program--beneficiaries who qualify for assistance for only part of a year could lose some or all of their benefits. Budgetary savings for each approach are shown both including and excluding those transfers that are already means-tested.

Non-means-tested *entitlement programs* included here are Social Security and Railroad Retirement, Medicare, unemployment compensation, and veterans' benefits. The analysis excludes two other major entitlement programs--federal civilian and military pensions--because they are part of the labor contract between the government and its employees and not transfers in the same sense that the included programs are. Several options to constrain spending on these two excluded programs are discussed in ENT-41.

Means-testing could be based on individual income, couple income, or the income of a more broadly defined family. The unit used determines which recipients would be affected by the alternative approaches, as well as how recipients might respond to means-testing. Because families generally consume as a unit, family income and wealth are probably better measures of need than individual income and wealth. Further, the family measures are greater than the individual measures, so applying the same dollar thresholds in means tests to families rather than individuals would affect more recipients. At the same time, depending on how the means tests are structured, basing the tests on families could induce families to split up into smaller units to minimize benefit reductions. For example, in the benefit reduction approach discussed below, a retired couple in which each spouse has $20,000 of pension and investment income and $10,000 of Social Security benefits; if they divorced, they would keep all of their benefits. Appropriate differentiation of benefit reductions for individuals and families of different sizes could reduce or remove such incentives for family breakup.

A significant objection to global means-testing of entitlements is that different programs serve different purposes. Individual programs provide people with separate types of in-kind consumption, such as food, housing, and medical care. Society may wish to ensure fuller access to these goods and services rather than simply provide more cash income. In this view, any limitation on benefits should be imposed on a program-by-program basis in order to allow different criteria to be applied.

Reducing entitlements to medical assistance raises special concerns. One problem is valuing medical services in dollar terms. One approach would base value on benefits actually received. This approach could yield unacceptable results because it would assign the highest values to the sickest people receiving the most care. Another approach would count the federal subsidy to in-kind programs as benefits. In Medicare, for example, the subsidy would be the implicit value of an insurance premium paid for by the government.

Means-testing benefits also poses a transitional problem, particularly for retirees. Recipients of benefits may have made financial decisions and plans expecting particular incomes from entitlements. Changing those benefits could impose hardships. Phasing in taxation of benefits or means tests over time would mitigate this difficulty.

Make All Entitlements Subject to Individual Income Tax. Under current law, some benefits of federal entitlement programs, such as unemployment compensation and military pensions, are fully subject to individual income taxes; others, such as Social Security, are partially so; and still others, such as Medicare and food stamps, are entirely excluded from taxable income. One approach to means-testing all entitlements would include in taxable income all federal entitlement benefits in excess of contributions made for specific programs. Thus, for example, the insurance value of Medicare in excess of

ance coverage would become part of a recipient's taxable income. Program administrators would tell recipients annually the net value of benefits to report as taxable income, using a form similar to the W-2 used to report wage income. Such inclusion for all entitlements would increase revenues by about $18.4 billion in 1995 and $264 billion from 1995 through 1999.

Taxing entitlements recognizes that entitlements increase a recipient's ability to pay taxes in the same way that other forms of income do. Excluding some entitlement payments from taxable income simply because they come from the government could be viewed as violating the principle that taxes should be higher for people with higher incomes. A counterargument, however, asserts that entitlements are not taxable now simply because benefit levels are set to be net of taxes. If those levels are too high, the Congress should reduce them within each individual program. Making benefits taxable does have the advantage of providing a straightforward annual measure of recipients' needs for federal assistance. Even so, it could be difficult to justify including noncash benefits received from the government, but not those provided by employers. This last objection is not an issue, however, if taxation of benefits is viewed as a means of allocating scarce government resources to the most needy recipients.

Reduce Benefits Provided to Middle- and High-Income Families. The Concord Coalition has recently proposed that federal entitlement benefits be reduced rapidly as incomes rise. Benefit reduction could be achieved either through supernormal tax rates imposed under the individual income tax or directly through new programmatic structures. Under the Concord Coalition's proposal, families with incomes above $40,000 would lose benefits under a graduated scale beginning at 10 percent for those with incomes between $40,000 and $50,000 and increasing by 10 percentage points for each $10,000 of income up to 85 percent of benefits above $120,000 of total income. Nontransfer income would be considered first in determining the rate of benefit reduction, and benefits would be reduced only to the extent that they caused total income to exceed $40,000. For example, a family receiving $15,000 of Social Security and $30,000 of percent of the $5,000 by which total income exceeds $40,000. If the family had $45,000 of nontransfer income, it would lose $2,500 of its Social Security--10 percent of the $5,000 that falls in the $40,000 to $50,000 income range and 20 percent of the $10,000 that falls in the $50,000 to $60,000 income range. A family with nontransfer income above $120,000 would have its benefits reduced by 85 percent. (Under the Coalition's plan, married couples and larger families would face the same income limits as single people, and all dollar values would be indexed for inflation.)

This option would reduce benefits for all entitlements by about $10.1 billion in 1995 and $206 billion over 1995 through 1999. Compared with the option that would tax benefits, this proposal to reduce benefits would have no effect on families with lower incomes and a greater effect on high-income families.

This approach reflects the view that entitlements should go primarily to those most in need of them, not to families with higher incomes. Imposing the same criteria for establishing need among all entitlement programs might be the fairest way to limit benefit payments. A global approach to benefit reduction could also be less costly to administer than an approach that addresses each program individually, although whether it would cost less depends in large part on whether new administrative apparatuses would have to be created.

A significant problem with this option is the disincentive for families to save and earn other income created by the rapid reduction in benefits as income rises. This effect would be mitigated somewhat, however, if the benefit reduction were phased in gradually over a wide income range. Recipients with incomes well above the $120,000 level at which benefit reduction is greatest would face smaller or no disincentives, since they would have to lower their incomes greatly to incur smaller benefit reductions. An alternative to forgoing income to lessen benefit reductions would be to shift income to sources that would not be counted in the benefit reduction formula. If, for example, interest on tax-exempt bonds were not counted, entitlement recipients would be expected to shift their investments

however, by counting as many forms of income as possible in determining benefit reductions.

Deny Entitlements to High-Income Recipients. Some Members of Congress have recently considered a third approach to means-testing entitlements that would deny completely any entitlement payments to recipients with incomes above specific limits. The budgetary savings shown assume limits of $100,000 for single recipients and $120,000 for married couples, with benefits phasing out over a $10,000 income range. This option would reduce spending on all entitlements by about $4.3 billion in 1995 and $46 billion over a five-year period. Compared with the proposal of the Concord Coalition to reduce benefits, this option would exempt middle-income families from benefit cuts and impose larger benefit reductions on families with the highest incomes.

This approach has many of the advantages of and problems faced by the alternative that would simply reduce benefits. Because benefits would be phased out over a narrow income band, however, the work and saving disincentives would be significantly greater for people with incomes near the cutoff level. Families with more than $10,000 in benefits and incomes in the phaseout range would face marginal tax rates of over 100 percent from this provision alone. The narrower the band, the more likely would be potential recipients with incomes in or just above the phaseout range to adjust the timing of their income receipts, forgo savings, or reduce work effort to stay under the income limit. At the same time, because beneficiaries with incomes below the phaseout range would continue to receive full benefits, many fewer recipients would face work and savings disincentives than in the approach that would reduce benefits over a broad income range. Any reduction in work effort or savings would reduce the budgetary savings. Finally, this approach would also create incentives to shift income to sources excluded from the income calculation.

Chapter Five

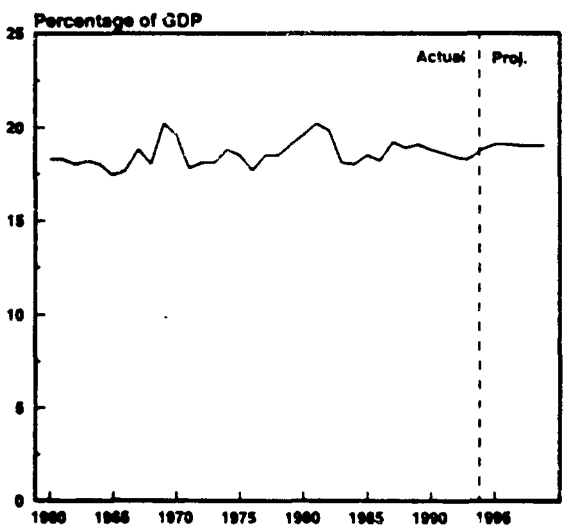
Revenues

Although policymakers just enacted substantial tax increases--especially on high-income families--some analysts suggest that even further tax increases are necessary. Organizations such as the Concord Coalition, for example, call for a balanced budget and argue that it is unrealistic to expect spending cuts alone to do the job. Further tax increases, however, are unlikely to spare lower- and middle-income families to the same extent as those increases recently enacted in the Omnibus Budget Reconciliation Act of 1993 (OBRA-93). This chapter presents 36 revenue-raising options that affect taxpayers at all income levels and include all the major revenue sources.

Currently, about 90 percent of federal revenue comes from income and payroll taxes. In 1993, the individual income tax raised 44 percent of federal revenue, the payroll tax 37 percent, and the corporate income tax 10 percent. In addition, excise taxes raised 4 percent of federal revenue. The rest came from estate and gift taxes, customs duties, and fees and other miscellaneous receipts.

Under its baseline assumption that the Congress enacts no legislation affecting revenues, the Congressional Budget Office expects the revenue share of gross domestic product (GDP) to average 19 percent over the next five years, very similar to the average share recorded since 1960 (see Figure 3). Since that year, the revenue share of GDP has dropped as low as 17.4 percent and risen as high as 20.2 percent, with an average value of 18.6 percent. The revenue share surpassed 20 percent in the late 1960s when the Congress enacted an income tax surcharge during the Vietnam War, and again in 1981 after several years of rapid inflation pushed reductions enacted in the Economic Recovery Tax Act of 1981 (ERTA), combined with back-to-back recessions in 1980 and 1981-1982, brought the revenue share down to 18 percent in 1983. ERTA also removed most inflationary bracket creep from the personal income tax by enacting--starting in 1985--indexation for inflation of the personal income tax bracket amounts, the standard deduction, and the personal exemption. In subsequent years, the revenue share, bolstered by sustained economic growth and deficit reduction measures, climbed to 19 percent in 1989. As a result of the 1990-1991

Figure 3.
Total Revenue as a Share of GDP

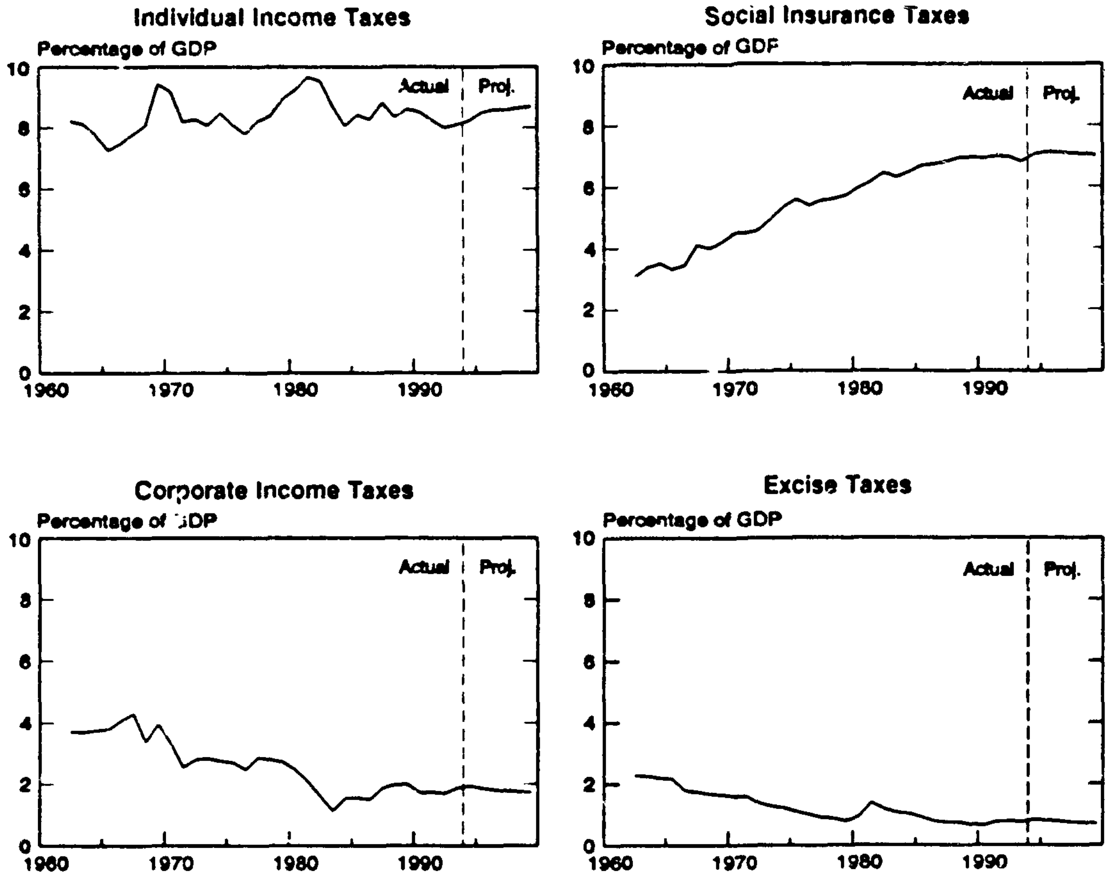


recession and the slow recovery that followed, the revenue share fell to 18.3 percent in 1993.

The long-term stability of the overall revenue share of GDP masks some important shifts in the major sources of revenue: individual, social insurance, corporate, and excise taxes (see Figure 4). Individual income taxes, like overall revenues, have risen and dipped as a share of GDP since 1960, but they are currently near their average level of 8 percent. Yet the GDP share claimed by social insurance taxes (mostly Social Security taxes) has increased steadily since 1960 as tax rates, coverage, and the share of wages subject to taxation have risen. Social insurance taxes have increased from 3 percent of GDP in 1960 to about 7 percent today.

The GDP shares claimed by corporate income taxes and excise taxes have fallen since 1960. The corporate revenue share declined steadily until the mid-1980s because of both a drop in corporate profits as a share of GDP and legislated reductions in tax liability. Corporate taxes as a share of GDP have risen slightly since the Congress raised corporate taxes in the Tax Reform Act of 1986. Excise taxes continue to be the smallest of the four major

Figure 4.
Revenues by Source as a Share of GDP



SOURCE: Congressional Budget Office.

venue sources. They have claimed a decreasing iare of GDP largely because they are often levied 1 the quantity, not the value, of goods. Moreover, e Congress has not in general raised the tax rates iough to keep pace with inflation.

The current mix of revenue sources translates to 1 overall burden of federal taxes that is moderately r-r-ssive, with higher-income families paying a eater share of their income in tax than lower-come families. CBO estimates that in 1994 fami-:s in the bottom income quintile will pay about 5 :rcent of their income in federal taxes, whereas milies in the middle income quintile will pay oout 19 percent and families in the top income iintile will pay nearly 28 percent. CBO measures e tax burden in relation to family income, which cludes all cash income received by families plus eir share of employer taxes and corporate income.

Looking at the tax burden over time, CBO finds at the sweeping changes in tax laws that took ace between 1977 and 1993 resulted in little dif-rence between the beginning and the end of that i-year period in either the overall share of income iid in federal taxes or the share of income paid by rious family income groups. The major exception that the share of income paid in taxes by families the lowest income quintile will be lower once the anges enacted in the Omnibus Budget Reconcilia-m Act of 1990 (OBRA-90) and OBRA-93 are lly implemented.

By 1990, most family income groups paid the me share of their income in federal taxes as com-rable families paid in 1977, except for the top 1 rcent of the income distribution, which paid a wer share. OBRA-90, however, increased the are of income these highest-income families paid taxes by raising the maximum marginal income (rate to 31 percent and limiting the benefits from mized deductions and personal exemptions for ose families. In addition, OBRA-93 added new lividual income tax rates of 36 percent and 39.6 rcent and made all earnings subject to the payroll t for Medicare. These changes will raise the total are of income paid in taxes by the highest-income nilies back to the level that existed for compa-ole families in 1977.

It is because of the substantial expansion of the earned income tax credit (EITC) enacted in OBRA-90 and OBRA-93 that the share of income paid in taxes by families in the lowest income quintile has gone down since 1977. The EITC is a refundable tax credit available to low income working families. Before OBRA-93, only working families with chil-dren could receive the credit. That act extended a smaller EITC to low-income working families with-out children.

As a share of income, the burden of income taxes is relatively greater for higher-income fami-lies, and the burden of payroll and excise taxes is relatively greater for lower-income families. The Congress can change the distributional burden of the tax system either by changing the shares of tax from different sources or by changing the distributional burden of income and payroll taxes. It can make the individual income tax more or less progressive by changing either the tax base or the rate schedule and, to a lesser extent, can alter the distribution of the payroll tax burden by changing the cap on wages that are subject to tax. Policymakers have little control over the distributional burdens of other tax sources.

Federal taxes also affect the allocation of eco-nomic resources in the private sector. Taxes inevi-tably create some distortion of private activities. For example, the individual income tax--whose tax base is widely accepted as a measure of the ability to pay tax--discourages work and saving by taxing their return. Similarly, the corporate income tax raises the cost of capital, discourages use of the corporate form of business, and encourages corpora-tions to finance their operations with debt rather than equity. In addition, the Congress has enacted certain incentives within the tax law to promote public policy goals that also affect the allocation of economic resources. For example, one rationale for allowing people to deduct contributions to charity under the income tax is to encourage charitable activities.

This chapter presents a broad range of options for increasing federal revenue. The options raise different amounts of revenue and affect economic incentives differently. They also differ in the way

they allocate economic resources among alternative uses and in the way they distribute the tax burden among taxpayers. Some options raise revenue from existing tax sources by increasing tax rates, broadening tax bases, or expanding tax coverage to include additional taxpayers. The government could put many of these options into place quickly and easily because the taxes are already in place. The other options raise revenue from new tax sources such as a federal value-added tax (VAT). Some of these options would impose additional compliance costs on taxpayers and administrative costs on the federal government because they would require additional tax computation methods and more Internal Revenue Service employees.

One revenue-raising option, to make all entitlements subject to the individual income tax, appears not in this chapter but in Chapter 4, which discusses entitlements and other mandatory spending. This option is part of ENT-57, which would apply a means test to federal entitlements.

Although most of the spending options presented in this volume would take effect on October 1, 1994, all but two of the revenue options take effect on January 1, 1995. The VAT option has a later effective date because implementing the tax would take more time. The option to increase excise taxes on tobacco and alcoholic beverages takes effect on October 1, 1994, consistent with the effective date for the President's proposed increase in the tobacco tax. The revenue estimates for the options, most of which the Joint Committee on Taxation prepared, may differ from estimates for similar provisions in specific tax bills as a result of differences in effective dates, transition rules, and technical details.

REV-01 RAISE MARGINAL TAX RATES FOR INDIVIDUALS AND CORPORATIONS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Individuals						
Raise Marginal Tax Rates to 16 Percent, 30 Percent, 33 Percent 38 Percent, and 42 Percent, and Top AMT Rate to 30 Percent	23.3	40.1	41.8	44.0	46.0	195.2
Raise the Top Marginal Tax Rates to 38 Percent and 42 Percent	3 9	6.3	6.0	6.2	6.0	28.4
Corporations						
Raise the Top Marginal Tax Rate to 36 Percent	1.6	2.8	3.0	3.0	3.1	13.5
Raise the ATM Rate to 25 Percent	2.3	3.7	2.9	2.8	2.7	14.4

SOURCE: Joint Committee on Taxation.

NOTE: AMT = alternative minimum tax.

Rate increases have two advantages over other tax changes as a means for raising revenue. First, they do not add to costs of enforcement or compliance because they do not increase the complexity of the tax code or the recordkeeping requirements of taxpayers. Second, the Treasury begins to receive the additional revenues relatively quickly because it can incorporate rate increases immediately in withholding and estimated tax schedules. But rate increases have drawbacks as well. Higher tax rates reduce incentives to work and save, and increase the inefficiencies that tax preferences produce. The Omnibus Budget Reconciliation Act of 1993 (OBRA-93) increased marginal tax rates, effective in 1993, for some individuals and corporations.

Individuals. Before OBRA-93, the income tax structure had three explicit marginal tax rates--15 percent, 28 percent, and 31 percent, with a maximum marginal tax rate on capital gains of 28 percent. (The marginal tax rate is the percentage of an extra dollar of income that a taxpayer must pay in taxes.) OBRA-93 added two more rate brackets of 36 percent and 39.6 percent for the highest-income taxpayers. Some high-income taxpayers will face effective marginal tax rates of more than 39.6 percent because of provisions that phase out their itemized deductions and personal exemptions. These provisions were originally scheduled to expire under prior law, but OBRA-93 made them permanent.

Increasing all marginal tax rates on ordinary income to 16 percent, 30 percent, 33 percent, 38 percent, and 42 percent (approximately a 7 percent increase) would raise about $195 billion in 1995 through 1999. This option also increases the top marginal tax rate under the alternative minimum tax (AMT) to 30 percent in order to keep the rate aligned with the regular tax rates and avoid a major shift of payments between the AMT and regular tax. The AMT is imposed on individuals at rates of 26 percent and 28 percent on a broader base. Individuals pay the larger of the AMT or the regular tax. Under this option, families with tax credits would face a somewhat larger percentage increase in their tax liabilities than other taxpayers, and families whose earned income tax credit gives them a tax refund might have to pay tax. (This option and the next one assume that the maximum rate on capital gains would remain at 28 percent.)

Another option is to increase only the top two marginal tax rates. Increasing the current 36 percent rate to 38 percent and the 39.6 percent rate to 42 percent would raise revenues by about $28 billion in 1995 through 1999. For 1995, this option would increase taxes for married couples with taxable income of more than $144,550 and single filers with taxable income of more than $118,700.

Corporations. Before OBRA-93, corporations also faced three explicit marginal tax rates--15 percent, 25 percent, and 34 percent. OBRA-93 added a new top statutory rate of 35 percent for a corporation's taxable income in excess of $10 million. The 15 percent and 25 percent marginal rates continue to apply to the first $75,000 of taxable income, and the 34 percent marginal rate now applies to taxable income between $75,000 and $10 million. As under the law prior to OBRA-93, corporations with taxable income above $100,000 pay a surtax in order to phase out the benefits of the 15 percent and 25 percent marginal rates. In addition, OBRA-93 added a second surtax bracket in order to phase out the benefit of the 34 percent rate (see REV-03).

Corporations also face the alternative minimum tax, which limits the use of tax preferences. When computing taxable income for the alternative minimum tax, taxpayers may not make certain adjustments to regular taxable income. These adjustments are of two types: deferral preferences, such as accelerated depreciation, excess intangible drilling costs, and profit or loss from long-term contracts; and exclusion preferences, such as some tax-exempt interest and percentage depletion. As with individuals, corporations must pay the larger of the regular tax or the AMT. However, corporations can use one year's AMT as a credit against regular tax liability in future years. Thus, a portion of the revenue gain from a higher AMT rate results from a shift of some future tax liabilities to earlier years.

Increasing the top marginal rate to 36 percent would raise about $13.5 billion in 1995 through 1999. Out of approximately 1 million corporations that have positive corporate tax liabilities each year, fewer than 3,000 corporations pay income taxes at the top rate and would be affected by this option. Nonetheless, these firms earn approximately 80 percent of all corporate taxable income. The change would not affect corporations that always pay the AMT. Moreover, those corporations paying the regular tax, but with unused credits, could offset some of the tax increase.

Proponents of the corporate AMT argue that it improves the perceived fairness of the tax system because it largely ensures that corporations reporting profits to shareholders pay the corporate tax. Critics maintain, however, that the corporate AMT places a greater tax burden on rapidly growing and heavily leveraged corporations and provides corporations with an incentive to engage in tax-motivated transactions. For example, a firm that expects to pay the AMT may be able to reduce its tax by leasing its equipment, rather than owning the equipment and using the accelerated depreciation tax preference. Increasing the corporate AMT rate to 25 percent would raise about $14.4 billion in 1995 through 1999. This tax change, however, would increase the use of these nonproductive tax minimization transactions.

Relationship Between Top Rates Affects Business Form. Changes in the difference between the top corporate and individual rates affect the form of organization a business chooses. Owners of corporate businesses pay both the corporate and individ-

owners of noncorporate businesses pay tax only at the individual level. OBRA-93 raised the top individual tax rate above the corporate tax rate, to about the relative position that had existed before the Tax Reform Act of 1986 was enacted. By making this change in relative rates, OBRA-93 made it relatively more advantageous for businesses that retain their earnings to choose the corporate form. Subsequent changes in this relationship would again alter the incentives of businesses that face this choice.

REV-02 AMEND OR REPEAL THE INDEXING OF INCOME TAX SCHEDULES

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Suspend Indexing for 1995 (Except for earned income tax credit)	5.0	8.4	10.2	11.7	10.7	46.0
Repeal Indexing (Except for earned income tax credit)	5.0	13.7	24.7	37.9	50.9	132.2

SOURCE: Joint Committee on Taxation.

To offset the effects of inflation, current law indexes annually the standard deduction, the personal exemption, the minimum and maximum dollar amounts for each tax rate bracket, the thresholds for the phaseout of personal exemptions, the limit on itemized deductions, and the earned income tax credit (EITC). A repeal of indexing (except for the EITC), beginning in 1995, would raise revenues by about $132 billion from 1995 through 1999, if the annual rate of inflation averages 3.0 percent over the period, as CBO projects. Revenues from the repeal would grow rapidly as the effect of repeal cumulates over time. Although suspending indexing only for 1995 would raise the same amount of revenues in the first year, it would raise much less in later years--about $46 billion over the five-year period.

Repealing or suspending indexing would not burden all taxpayers equally. Among families with the same income, taxpayers who itemize would generally bear a smaller tax increase than those who use the standard deduction, and families with children (and more personal exemptions) would be affected more than families without children. Low-income families would have a smaller percentage drop in after-tax income than other families because they have little or no taxable income. The percentage drop in after-tax income would also be small for families with the highest incomes because they receive no benefit from the personal exemption, and most of them do not take the standard deduction. A general rate increase would allocate additional taxes more equally among families with the same income than repealing or suspending indexing (see REV-01).

Another reason for retaining indexing is that it allows the Congress to decide explicitly on tax increases. Without indexing, inflation would cause the average income tax rate to increase without any legislative action.

REV-03 TAX ALL CORPORATE INCOME AT A 35 PERCENT RATE

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year
	1995	1996	1997	1998	1999	Addition
Addition to CBO Baseline	1.9	3.5	3.5	3.6	3.7	16.2

SOURCE: Joint Committee on Taxation.

Under current law, corporations pay a 35 percent statutory tax rate on their taxable income in excess of $10 million, with income below that amount subject to tax at reduced rates of 15 percent, 25 percent, and 34 percent. The reduced rates provide a tax benefit only to corporations with taxable income below $18.3 million because corporations with income exceeding this amount face additional tax rates of 3 percent and 5 percent on some of their income. Corporations with taxable income between $10 million and $15 million receive $100,000--the maximum benefit from the lower rates. Eliminating the reduced corporate rates and taxing all corporate income at the single 35 percent rate would raise an estimated $16.2 billion from 1995 through 1999.

Corporations face four marginal tax rates that are augmented by the two additional tax rates that phase out the benefits of the reduced rates for firms in limited income ranges. Firms with taxable income below $75,000 have the lowest tax rates of 15 and 25 percent. Firms with taxable income between $75,000 and $10 million have a tax rate of 34 percent on income in that range, and those with income above $10 million have a 35 percent rate. The tax benefit from the 15 percent, 25 percent, and 34 percent rates is reduced for corporations with income above certain amounts by an additional 5 percent tax that is levied on corporate taxable income between $100,000 and $335,000 and a 3 percent additional tax on income between $15 million and $18.3 million. As a result, corporations with income of more than $18.3 million pay an average rate of 35 percent and receive no benefit from the reduced rates.

that have positive corporate tax liabilities each year, all but approximately the most profitable 3,000 qualify for reduced rates, although the lower-rate corporations earn only about 20 percent of total corporate profits. This provision not only provides a competitive advantage to some small and moderate-sized businesses, but other taxpayers benefit as well. For example, high-income individuals benefit because the provision allows them to shelter income as retained earnings in a small corporation. The tax law does not allow owners of personal service corporations, such as physicians, attorneys, and consultants, to incorporate themselves in order to gain the tax benefit. Others still use these opportunities for tax shelters, however. The Omnibus Budget Reconciliation Act of 1993 increased the incentive to use these shelters by raising the top statutory income tax rate for individuals by nearly 9 percentage points while raising the top statutory rate for corporations by only 1 percentage point. Additional unintended recipients of the tax benefit are large businesses with low profits. Some of these large corporations, furthermore, may be able to control the timing of certain income and expenses in order to generate low taxable income--and the tax benefit--in certain years.

Lower corporate rates are not the only means of reducing the double tax on income from these businesses. As an alternative to incorporation, many businesses--especially small ones--could operate as sole proprietorships or partnerships and pay tax only under the individual income tax. In addition, many small businesses could continue to enjoy the advantages of incorporation by operating as S corporations, which must have 35 or fewer owners and

REV-04 ELIMINATE OR LIMIT DEDUCTIONS FOR MORTGAGE INTEREST

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Eliminate Mortgage Interest Deductions	25.6	52.4	55.3	58.7	62.1	254.1
Reduce Maximum Mortgage Principal Eligible for Interest Deductions to $300,000	1.6	4.5	4.7	4.8	5.0	20.6
Limit Deductions to $12,000 per Return (Single) or $20,000 (Joint)	2.4	7.0	7.2	7.4	7.6	31.6
Limit Deductions for Second Homes	0.2	0.6	0.6	0.6	0.6	2.6

SOURCE: Joint Committee on Taxation.

A home is both the largest consumer purchase and the main investment for most Americans. The tax code has historically treated homes more favorably than other investments. Current law allows homeowners to deduct mortgage interest expenses, even though homes do not produce taxable income, and exempts most capital gains from home sales (see REV-20). Such preferential treatment may benefit neighborhoods because it encourages home ownership and home improvement. The amount of preference, however, is probably larger than needed to maintain a high rate of home ownership. For example, Canada, which grants preferential tax treatment to capital gains from home sales but does not allow deductions for mortgage interest, has achieved about the same rate of home ownership as the United States.

The tax advantages for owner-occupied housing encourage people to invest in homes instead of taxable business investments. This shift may contribute to a relatively low rate of investment in business assets in the United States compared with other developed countries that do not allow such large mortgage interest deductions. Currently, about one-third of net private investment goes into owner-occupied housing, so even a modest proportional shift of investment to other sectors could have important effects.

Limiting mortgage interest deductions would substantially reduce the preferential treatment of owner-occupied homes, particularly for those homeowners who must borrow to purchase their homes. Under current law, taxpayers may deduct interest on up to $1 million of debt they have used to acquire and improve first and second homes and interest on up to $100,000 of other loans they have secured with a home, regardless of purpose (home-equity loans). No other type of consumer interest is deductible. Current law also limits the extent to which interest deductions for carrying assets other than first and second homes can exceed income from such assets. One way for taxpayers to circumvent the restrictions on consumer and investment interest deductions is to finance consumer purchases and investments in assets other than homes with home-equity loans.

The limits under current law on mortgage interest deductions result in a generous subsidy even for relatively expensive homes. Moreover, taxpayers with substantial home equity can circumvent the limits on consumer and investment interest by using, for example, home equity loans with deductible interest to finance automobiles. In contrast, renters and those with small amounts of home equity cannot use this method to deduct interest on loans they use to finance auto purchases.

Eliminate Interest Deductions. Eliminating the deductibility of mortgage interest would raise the taxes of about 27 million homeowners by an average of about $1,900 in 1995 and increase tax revenues by about $254 billion over the 1995-1999 period. Housing as an investment would be made more nearly equal with other investment opportunities, thus reducing the incentive to overinvest in housing. Furthermore, eliminating the deduction would remove the opportunity for homeowners to circumvent provisions in the tax law that deny the deductibility of interest on other types of consumer expenditures. But eliminating the mortgage interest deduction would increase housing costs sharply for current homeowners, potentially making it impossible for them to afford their homes. Homeowners could not fully avoid these costs by moving because the prices of owner-occupied homes would fall. Finally, the costs of eliminating the deduction would fall most heavily on those who do not have sufficient other assets to purchase homes without mortgages, thus disproportionately affecting homeowners with lower wealth and incomes.

Reduce the Principal Eligible for Deduction. Lowering the limit on the amount of principal eligible for the mortgage interest deduction from $1 million to $300,000 would reduce deductions for about 1.1 million taxpayers with large mortgages and increase revenues by about $21 billion over the 1995-1999 period. This change would reduce the deduction only for owners of relatively expensive homes. It would not affect the vast majority of homeowners, but would impose large adjustment costs on some homeowners in high-cost housing areas.

Cap Interest Deductions. Capping the mortgage interest deduction at $12,000 per single return, $20,000 per joint return, and $10,000 per return for married couples who file separately would raise about $32 billion in revenues in 1995 through 1999. These limits are much higher than the deductions most taxpayers claim. Of the 27 million taxpayers who claimed the mortgage interest deduction in 1991, about 1.6 million (6 percent) had deductions that exceeded these limits; the average deduction for home mortgage interest was about $7,500. At current mortgage interest rates, the proposed $20,000 cap would allow full interest deductions on new fixed-rate mortgages as large as about $275,000. Only 3 percent of new mortgages originated in 1993 were for amounts of $275,000 or more.

Capping mortgage interest deductions would retain the basic tax incentive for home ownership without subsidizing the luxury component of the most expensive homes and vacation homes. Because the caps are higher than the deductions most homeowners now take, the caps would affect home prices and homebuilding in only a small segment of the market. Moreover, because the proposal would not index caps for inflation, their real value would gradually decline. Phasing down the deduction gradually would cushion the effects on current homeowners and the homebuilding industry.

Like the other limits on interest deductions, the cap would be more restrictive in areas with higher housing costs. Further, in periods of high interest rates, the limits would affect recent homebuyers and those with adjustable-rate mortgages more than longer-term owners with fixed-rate mortgages.

Limit Interest Deductions for Second Homes. A final option is to limit deductibility to interest on debt taxpayers incur to acquire and improve a primary residence, plus $100,000 of other debt secured by that home. That approach would require interest deductions for second homes to qualify under the $100,000 limit on home-equity loans. The proposal would increase revenue by $2.6 billion in 1995 through 1999. The deduction under current law provides special treatment for taxpayers who borrow to own second homes, relative to taxpayers who cannot deduct interest when they borrow to finance education, medical expenses, and other consumer purchases.

REV-05 ELIMINATE OR LIMIT DEDUCTIONS OF STATE AND LOCAL TAXES

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Eliminate Deduction of State and Local Taxes	16.8	41.0	41.7	44.5	47.3	191.3
Limit Deductions to the Excess Over 1 Percent of Adjusted Gross Income	1.9	6.5	6.9	7.3	7.7	30.3
Prohibit Deductibility of Taxes Above Ceiling of 8 Percent of Adjusted Gross Income	2.0	6.4	6.9	7.5	8.1	30.9

SOURCE: Joint Committee on Taxation.

Under current law, taxpayers may deduct state and local income, real estate, and personal property taxes from their adjusted gross income (AGI). For taxpayers who itemize, the deductions provide a federal subsidy of state and local tax payments. This subsidy may cause itemizers to support higher levels of state and local services than they would otherwise; consequently, the deductions indirectly finance increased state and local government spending at the expense of other uses of federal revenues.

The Tax Reform Act of 1986 reduced the subsidy to state and local governments directly by repealing the deduction for state and local sales taxes, and indirectly by increasing the standard deduction and lowering marginal rates. The latter changes reduced both the number of itemizers and the value of the deductions. The Omnibus Budget Reconciliation Act of 1993 raised marginal tax rates for higher-income households and thus indirectly increased the value of the deductions.

As a way to assist state and local governments, deductibility of state and local taxes has several disadvantages. First, the deductions reduce federal tax liability only for itemizers. Second, because the value of an additional dollar of deductions increases with the marginal tax rate, the deductions are worth more to higher-bracket taxpayers. Third, deductibility favors wealthier communities. Communities with higher average income levels have more residents who itemize and are therefore more likely to spend more because of deductibility than lower-income communities. Fourth, deductibility may discourage states and localities from financing services with nondeductible user fees, thereby discouraging efficient pricing of some services.

An argument against restricting deductibility is that a taxpayer with a large state and local tax liability has less ability to pay federal taxes than one with equal total income and a smaller state and local tax bill. But a taxpayer who pays higher state and local taxes often receives more benefits from publicly provided services, such as recreational facilities. In that case, the taxes are more like other payments for goods and services (for example, private recreation) and should not be deductible. This comparison is not perfect because any higher public expenditures resulting from deductibility benefit all members of a community, including lower-income nonitemizers who do not receive a direct tax saving.

Eliminating or limiting the value of the state and local deduction could raise significant revenues

Eliminating deductibility would raise about $191 billion in 1995 through 1999. An alternative option wo 'low deductions only for state and local tax p s above a fixed percentage of AGI. The itemizer's state and local tax deductions percent of AGI in every state. A 1 perce r on deductions would increase revenues in 1995 through 1999 by $30.3 billion. Another alternative would be to prohibit deductions above a fixed ceiling, which also might be a percentage of AGI. A ceiling set at 8 percent of AGI would increase revenues by a roughly similar amount--$30.9 billion in 1995 through 1999. A floor and a ceiling, however, would have very different effects on incentives for state and local spending. A floor would retain the incentive for increased spending, but a ceiling would reduce it.

REV-06 ELIMINATE OR LIMIT DEDUCTIONS FOR CHARITABLE GIVING

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Eliminate Deductions for Charitable Giving	1.8	17.6	18.6	19.4	20.3	77.7
Limit Deductions for Appreciated Property to Its Tax Basis	0.1	1.0	1.1	1.1	1.1	4.4
Limit Deductions to the Excess Over 2 Percent of Adjusted Gross Income	0.8	8.2	8.6	9.1	9.5	36.2

SOURCE: Joint Committee on Taxation.

Under current law, taxpayers who itemize deductions can deduct the value of contributions they make to qualifying charitable organizations. The amount of deductions cannot exceed 50 percent of adjusted gross income in any year. In 1991, 30 million taxpayers claimed $60 billion of deductions for charitable contributions, reducing federal revenues by about $15 billion.

In addition to cash donations, taxpayers can currently deduct the fair market value of a contribution of appreciated property that they have held for more than 12 months, regardless of how much they paid for the property. The Omnibus Budget Reconciliation Act of 1993 permanently eliminated the treatment of donated appreciated property as a tax preference for the purposes of the alternative minimum tax.

Eliminating the deductibility of charitable contributions would increase tax revenues by $1.8 billion in 1995 and by about $78 billion over the 1995-1999 period. In 1996, it would increase tax payments of more than 30 million taxpayers by an average of nearly $600 per return.

The deduction provides significant government support for charitable activities. But one criticism of the deduction is that the electorate as a whole, and not individual donors, should make decisions about which activities deserve taxpayer support. Another criticism is that the deduction provides unequal federal matching rates for contributions by different taxpayers. The government subsidy rates are nearly 40 percent of contributions for the highest-income taxpayers, only 15 percent for taxpayers in the lowest tax bracket, and zero for people who do not itemize deductions.

Nonetheless, the decisions of individuals about donations may be the best measure of which activities should receive government support and yield substantial contributions. Without deductibility, contributions might drop precipitously.

Limiting the deduction of appreciated property to a taxpayer's cost of an asset under the regular income tax would increase revenues by about $0.1 billion in 1995 and by $4.4 billion over five years. The existing provision allows taxpayers to deduct the entire value of assets they contributed even though they paid no tax on the gain from appreciation. This outcome provides preferential treatment of one kind of donation relative to other kinds and expands the preferential treatment of capital gains (see REV-21). However, the provision encourages people to donate appreciated assets to eligible activities rather than passing them on to their heirs at death, when any gains also escape income tax.

Another way to limit the charitable deduction, while retaining an incentive for giving, is to allow taxpayers to deduct only those contributions in excess of 2 percent of adjusted gross income. This alternative would retain an incentive for increased giving by people who give large shares of their incomes but would remove the incentive for smaller contributors. It would completely disqualify the charitable deductions of about 20 million taxpayers in 1995 and reduce allowed deductions for an additional 14 million, increasing revenues by about $0.8 billion in 1995 and by $36 billion over the 1995-1999 period. Such a change would eliminate the tax incentive for more than 60 percent of the taxpayers who currently make and deduct charitable contributions. In addition, it would encourage taxpayers who planned to make contributions over several years to lump them together into one tax year to qualify for a deduction with the 2 percent floor.

REV-07 LIMIT THE TAX BENEFIT OF ITEMIZED DEDUCTIONS TO 15 PERCENT

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	25.3	56.8	60.3	64.0	67.9	274.3

SOURCE: Joint Committee on Taxation.

Current law allows taxpayers to reduce taxable income by the amount of itemized deductions in excess of the standard deduction. Taxpayers who itemize may deduct state and local income and property taxes, home mortgage interest payments, contributions to charity, moving expenses, casualty and theft losses, and medical and dental expenses. Current law limits some itemized deductions to the amount in excess of a percentage of adjusted gross income and reduces all itemized deductions for high-income taxpayers.

The tax benefit of itemized deductions increases with a taxpayer's marginal tax bracket. For example, $10,000 in itemized deductions would reduce taxes by $1,500 for a taxpayer in the 15 percent tax bracket, $2,800 for a taxpayer in the 28 percent bracket, and $3,960 for a taxpayer in the 39.6 percent bracket. Most taxpayers do not itemize deductions. Among the one in five taxpayers who do itemize, however, about half are in tax brackets above 15 percent. This option would limit the tax benefit of itemized deductions to 15 percent for these higher-bracket taxpayers. The limit would increase revenues by about $274 billion over five years.

Limiting the tax benefit of itemized deductions would make the income tax more progressive by raising average tax rates for most middle- and upper-income taxpayers. The limit might also improve economic efficiency because it would reduce tax subsidies that distort the after-tax prices of goods, such as owner-occupied housing.

The itemized deductions for health expenses, casualty losses, and employee business expenses, however, are not subsidies to voluntary activities, but are instead allowances for costs that reduce the ability to pay income tax. Under this option, some taxpayers would pay tax on receipts they use to defray such costs because they would pay tax on their gross income at rates above 15 percent, but could deduct only 15 percent of the cost of earning income. Thus, an individual with unusually high medical bills, for example, would pay more tax than another individual with the same ability to pay but who has low medical bills.

Like other limits on itemized deductions, this option would create incentives for taxpayers to avoid the limit by converting itemized deductions into reductions in income. For example, taxpayers might draw down assets to repay mortgages, reducing both income and mortgage payments, or donate time or services rather than cash to charities. The option would also make calculating taxes more complex for itemizers.

REV-08 DECREASE LIMITS ON CONTRIBUTIONS TO QUALIFIED PENSION AND PROFIT-SHARING PLANS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Decrease Limits for Defined Benefit Plans to the Social Security Wage Base (With equivalent reductions for defined contribution plans)	0.4	1.3	1.5	1.4	1.4	6.0
Decrease the Limit for Deferrals in Salary Reduction Plans to $4,000	0.4	0.5	0.6	0.7	0.7	2.9

SOURCE: Joint Committee on Taxation.

Saving for retirement through employer-provided qualified pension and profit-sharing plans provides two tax advantages: it exempts from taxes the investment income earned by the assets in qualified plans, and it defers tax on employer contributions to qualified plans until retirement, when an employee's marginal tax rate is often lower.

Decrease Limits on Employer Contributions. Section 415 of the tax code establishes limits on the benefits that an employer can fund in qualified plans for any employee. The limits depend on the type of plan the employer offers.

Defined contribution plans specify how much the employer will contribute for each employee's retirement--for example, 5 percent of pay. The employee's pension depends on how much the employee's retirement fund accumulates by the time he or she retires. Current law limits annual contributions to such plans to 25 percent of compensation or $30,000, whichever is less.

Defined benefit plans specify the pension amount employees will receive in retirement, which is usually a percentage of preretirement earnings. Employers adjust their annual contributions so that enough will accumulate by the time the employee retires to pay the promised pension. Current law limits contributions to defined benefit plans so that annual benefits for pensions that begin at age 65 are no more than 100 percent of preretirement wages or $118,800 for 1994, whichever is less. The tax law reduces this limit on an actuarial basis for pensions that begin at an earlier age. When an employer sponsors both types of plans, a higher limit applies--the lesser of 140 percent of wages or $148,500 for 1994.

The limits on employer contributions are intended to limit the size of the tax benefits received by highly paid people. These people are better able to provide adequately for retirement without the full tax benefits and may use pensions to shelter nonretirement saving from taxation. Furthermore, providing full tax benefits for these people would reduce the progressivity of the tax code.

The main argument for lowering the current limits on contributions is that they allow the funding of pensions far higher than the preretirement earnings of most workers. Two percent of people who worked full time throughout 1992 earned as much as $100,000, yet current limits allow the funding of

pensions up to $118,800. Workers who accrue pensions this large are unlikely to need the full tax advantage to provide adequately for their retirement. Limiting funding for defined benefit plans to amounts necessary to pay benefits equal to the Social Security wage base ($60,600 in 1994), and making proportionate reductions in limits for defined contribution plans, would raise $6 billion from 1995 through 1999 because more employment income would be subject to taxes. These limits would still be higher than the earnings of all but about 9 percent of full-time workers.

One argument against reducing funding limits is that it would make participation less attractive to high-income business owners and top managers and thus might discourage them from sponsoring these plans for both themselves and their employees. Although the higher-paid managers and owners may not need tax-advantaged pension plans to save adequately for retirement, their employees might. A further argument against reducing the limits is a concern that national saving is too low. Limiting incentives for pension saving could reduce total saving.

Limit 401(k) Deferrals to $4,000. Section 401(k) of the tax code allows employees to choose to receive lower current (taxable) compensation and to defer the remainder of compensation as a contribution to the plan. Similar arrangements are possible for some workers in the nonprofit sector (403(b) tax-sheltered annuities), for federal workers, and for workers enrolled in some simplified employer plans (SEPs).

Section 402(g) specifies indexed limits for employee deferrals. In 1994, the limit for deferrals to 401(k) plans, SEPs, and the federal plan is $9,240. A temporarily higher limit of $9,500 exists for tax-sheltered annuities authorized under section 403(b). Limiting deferrals in all plans with cash or deferred arrangements to $4,000 in 1995, and indexing this limit thereafter, would raise about $2.9 billion in 1995 through 1999.

Lowering the limit would affect higher-income workers who are likely to provide adequately for their own retirement without the tax incentive. In addition, many employers have added 401(k) plans on top of other pension plans that already meet the basic retirement needs of employees. The 401(k) plans provide supplementary saving for those who prefer higher retirement income. Thus, limiting contributions to 401(k) plans would not threaten the basic retirement security of these workers.

Alternatively, higher limits provide a greater incentive for employers to initiate the plans, which benefit employees at all income levels. In particular, 401(k) plans appeal to small employers who have traditionally not established pension plans. Lower limits may discourage small employers from offering what could be the only retirement benefit available to their employees. Lowering limits on these plans and not on other plans encourages traditional pensions, which are primarily defined benefit plans. Unlike defined benefit plans, 401(k) plans and other defined contribution plans do not discriminate against workers who change employers or drop out of the work force temporarily. In addition, the voluntary nature of plans with cash or deferred arrangements allows workers who have spouses without coverage to save more for retirement than other workers.

Recent Change in Other Funding Limit. In addition to the section 415 and section 402(g) limits described above, section 401(a)(17) limits the amount of compensation that can be considered in calculating an employee's benefits. The Omnibus Budget Reconciliation Act of 1993 reduced this compensation limit from $235,840 in 1993 to $150,000 in 1994 and provided for indexing of the limit in subsequent years. The reduction was estimated to raise $2.5 billion between 1994 and 1998.

The section 415 and section 402(g) limits primarily restrict pension benefits for high-income employees with generous pension plans. The compensation limit primarily restricts pension benefits for all high-income employees.

REV-09 IMPOSE A 5 PERCENT TAX ON INVESTMENT INCOME OF PENSION PLANS AND INDIVIDUAL RETIREMENT ACCOUNTS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	6.9	11.4	12.1	12.9	13.6	56.9

SOURCE: Joint Committee on Taxation.

Under normal income tax rules, the interest earnings of savings accounts are fully taxable each year. The absence of this annual tax is one of the tax advantages for employer pensions and individual retirement accounts (IRAs). Instituting a tax at a low rate on the earnings of pension funds and IRAs would reduce the size of this advantage. A 5 percent tax rate would raise $56.9 billion between 1995 and 1999. (The other tax advantage of pensions and IRAs is the deferral of tax on contributions until retirement, when an employee's marginal tax rate is often lower.)

The tax advantages for pensions and IRAs encourage firms and workers to provide for retirement. Most studies of pensions find that they increase saving; the studies of IRAs are less conclusive. Although the tax advantages promote a public objective, many people receive little or no benefit from them. Only about half of employees receive pension coverage or contribute to IRAs. The largest pension benefits go disproportionately to higher-paid workers or to workers with long-term employment at large firms.

Imposing a tax at a low rate on pension and IRA earnings would reduce the tax advantage of saving for retirement through these vehicles. This tax would reduce the use of pensions and IRAs slightly and probably result in less retirement saving. The smaller tax advantage for pensions and IRAs would, however, make the tax burden between those with pensions and IRAs and those without them slightly more equal. It would also increase taxes relatively more for higher-paid workers.

Taxing pension and IRA earnings would affect more taxpayers than would lower limits on employer contributions to pension plans (see REV-08). Lowering the contribution limits increases taxes on a small number of the highest-paid workers, and would increase taxes substantially for some of them. Taxing pension and IRA earnings affects workers throughout the income distribution, and because it affects so many more workers, it could raise more revenue with a smaller impact for each employee who pays more tax.

Taxing the annual earnings of pension funds and IRAs would encourage fund managers to shift their investments toward assets that appreciate in value, such as growth stocks and real estate, because they can defer tax on capital gains until realization (see REV-21). To obtain this tax deferral, however, pension funds would have to invest in riskier assets. Although this portfolio shift would reduce the security of workers' retirement funds, it would make it easier for risky enterprises to obtain funding.

REV-10 TAX NONRETIREMENT FRINGE BENEFITS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Tax Some Health Insurance Premiums			(see REV-16)			
Tax Life Insurance Premiums						
Income tax	1.4	2.0	2.1	2.2	2.2	9.9
Payroll tax[a]	0.8	1.2	1.2	1.3	1.3	5.8
Impose a 3 Percent Excise Tax on the Value of Nonretirement Fringe Benefits[a]	5.6	8.4	9.1	9.8	10.6	43.5

SOURCE: Joint Committee on Taxation.

a. Estimates are net of reduced income tax revenues.

Employee compensation is taxable unless the tax code contains an explicit exception. Such exceptions apply to most employer-paid nonretirement fringe benefits because of provisions in the tax law that exclude them from the income and payroll tax bases even though they constitute current compensation to employees. Exempting fringe benefits from taxation reduces revenues substantially. For employer-paid health and life insurance premiums alone, the revenue loss will be about $55 billion in income taxes and $37 billion in payroll taxes in 1995. In addition, the law explicitly excludes from gross income employer-paid dependent care and miscellaneous benefits such as employee discounts, parking valued below a specified limit, and athletic facilities.

These exclusions reduce economic efficiency because employees receive tax-free benefits that they might purchase in lesser amounts with after-tax income. Moreover, the availability of tax-free services for some people can increase prices, thus depriving others who may value the services as much or more. For example, employer-paid health insurance plans have contributed to the demand for health care services, which in turn has contributed to sharp rises in health care costs. All consumers of health care pay the higher prices, not just recipients of tax-free insurance.

The tax treatment of fringe benefits provides proportionately greater benefits for higher-income people because they face higher marginal tax rates and typically receive more fringe benefits than do low-wage workers. It also creates inequities among people with the same income because people cannot convert income to tax-exempt fringe benefits easily or without cost. Thus, a taxpayer receiving no fringe benefits pays more tax than another with the same total income but a larger share in the form of fringe benefits. (If cash income and tax-exempt fringe benefits were closer substitutes, the exclusion would produce less inequity, but it would reduce efficiency more.) The Omnibus Budget Reconciliation Act of 1993 increased the inequity of the exclusion by raising tax rates on higher-income households.

Making all fringe benefits taxable, however, would present problems in valuing benefits and in assigning their value to individual employees. Few appraisal problems arise when the employer pur-

chases goods or services and provides them to employees, but it is more difficult to determine the value of a facility, such as an athletic facility, that employers provide. Further difficulties arise if the employer must allocate to individual employees the total value of the fringe benefits they provide. For example, in cases where the employer provides a service, such as employee discounts, it might be unfair to assign the same taxable value to all employees regardless of their level of use. It could be administratively complex, however, to assign values that depend on each worker's use. Further, the costs of collecting taxes on small fringe benefits (such as employee discounts) could exceed the revenue collected.

The per-employee value of employer-paid health and life insurance would be relatively easy to determine. Employers could report the premiums they pay for each employee on the employee's W-2 form and compute withholding in the same way as for wages. Employers already withhold taxes on some life insurance premiums (see below). Measuring insurance values would be more difficult for benefits that employers provide directly, such as medical care or reimbursement for medical costs that employees incur under self-insurance plans.

Another way to tax nonretirement fringe benefits would be to collect from employers a tax on the total cost of the fringe benefits they provide. Although the difficulty of determining the cost of some fringe benefits would remain, this option would eliminate the need to assign the value of benefits to individual employees.

Tax Some Employer-Paid Health Insurance Premiums. The present exclusion for employer-paid health insurance premiums favors recipients of employer-provided insurance over taxpayers who must pay for their own health insurance. Although the former receive tax-free insurance benefits, the latter can only deduct medical expenses, including insurance payments, in excess of 7.5 percent of their adjusted gross income, and then only if they are itemizers. (REV-16 describes two options to tax some employer-paid health insurance premiums.) In addition, through the end of 1993, a self-employed individual was able to deduct as a business expense up to 25 percent of the amount paid for family health insurance coverage. The President's proposed Health Security Act would make the deduction permanent and replace it with a deduction of up to 100 percent of such expenses.

Tax Employer-Paid Life Insurance Premiums. The tax law excludes from taxable income premiums that employers pay for group term life insurance, but limits the exclusion to the cost of the first $50,000 of insurance. Employer-paid premiums in excess of this amount are taxable under both the income tax and the payroll tax. The exclusion is not available to the self-employed. Making all employer-paid premiums taxable would add about $10 billion to income tax revenues and about $6 billion to payroll tax revenues from 1995 through 1999.

This change would leave a preference for death benefits provided by many employers under pension plans as substitutes for life insurance. Employees can defer income tax and pay no payroll tax on employer contributions to pension plans. Also, the first $5,000 of employee death benefits are tax exempt. If the Congress made employer-paid life insurance plans taxable, employers might choose to offer less life insurance and larger death benefits on pension plans instead.

Impose an Excise Tax on the Value of Nonretirement Fringe Benefits. An alternative to including employer-provided benefits as income to recipients would be to impose on employers an excise tax on the value of the benefits that they provide. These benefits would include the employer's share of health insurance, premiums to fund the first $50,000 of life insurance, dependent care, athletic facilities, employee discounts, and parking with a value up to the amount above which it is currently taxed. (Under current law, employees must include in taxable income in 1994 the market value in excess of $155 per month, indexed for inflation beyond 1994, of any parking provided free of charge by an employer.) A 3 percent tax, for example, would raise about $43.5 billion from 1995 through 1999. The bulk of these revenues would come from taxing employer-paid health insurance.

Under this option, employers would need to know only their total fringe benefit costs; they

would not have to place a value on the benefits paid to each employee. Because the 3 percent excise tax rate would be much lower than the tax rate on wages, this option would maintain most of the incentive for employers to provide fringe benefits instead of taxable wages.

A flat-rate excise tax on employers would be relatively more favorable to higher-income employees than including fringe benefits in employees' taxable incomes. Under an excise tax, the rate would not rise with the income of employees, as it would if the benefits were subject to the income tax.

REV-11 TAX THE INCOME-REPLACEMENT PORTION OF WORKERS' COMPENSATION AND BLACK LUNG BENEFITS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	1.5	4.1	4.2	4.4	4.6	18.8

SOURCE. Joint Committee on Taxation.

Current law exempts workers' compensation and Black Lung benefits from income taxation. Taxing the portion of these benefits that replaces the income employees lose from work-related injuries or black lung disease would increase revenues by $18.8 billion from 1995 through 1999. The remaining portion, which reimburses employees for medical costs (about 40 percent), would continue to be exempt from taxation.

Taxing the income-replacement portion of workers' compensation and Black Lung benefits would make the tax treatment of these entitlement benefits comparable to the treatment of unemployment benefits and the wage-replacement benefits that employers provide through sick pay and disability pensions. It would also improve work incentives for disabled workers who are able to return to work. (Under current law, the after-tax value of the wages they are able to earn may be less than the tax-free benefits they receive while disabled.)

An argument against taxing these benefits is that legal or insurance settlements for non-work-related injuries are not taxable, even if a portion of them reimburses lost income. Hence, taxing workers' compensation benefits would treat these two types of compensation inconsistently.

REV-12 INCREASE TAXATION OF SOCIAL SECURITY AND RAILROAD RETIREMENT BENEFITS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Tax 85 Percent of Benefits for All Recipients	8.5	21.4	22.2	23.0	23.8	98.9
Tax 50 Percent of Benefits Below and 85 Percent of Benefits Above $44,000 (Couples) and $34,000 (Individuals)	4.1	10.5	10.9	11.2	11.6	48.3
Tax 85 Percent of Benefits for Taxpayers with Income Above $32,000 (Couples) and $25,000 (Individuals)	0.4	0.8	0.9	1.0	1.0	4.1

SOURCE: Joint Committee on Taxation.

Social Security and Railroad Retirement (Tier I) together constitute the federal government's largest entitlement program. The government can reduce benefits from these programs by changing the benefit formula (see ENT-48 through ENT-51), reducing cost-of-living adjustments (see ENT-56), or including a greater portion of benefits in taxable income (see ENT-57). Unlike changing the benefit formula or freezing cost-of-living adjustments, increasing the fraction of benefits subject to tax reduces the additional burden for low-income families whose principal source of income is Social Security.

The Omnibus Budget Reconciliation Act of 1993 (OBRA-93) increased the fraction of Social Security and Tier I benefits subject to tax from 50 percent to 85 percent for higher-income taxpayers. Under current law, a taxpayer first calculates his or her combined income, which is the sum of adjusted gross income (AGI), nontaxable interest income, and one-half of Social Security and Tier I benefits. If a taxpayer's combined income exceeds a fixed threshold, he or she includes a fraction of benefits in AGI. The thresholds at which 50 percent of benefits are subject to tax are $25,000 for single returns and $32,000 for joint returns. OBRA-93 added new income thresholds, $34,000 (single) and $44,000 (joint), above which 85 percent of benefits become subject to tax. Because the thresholds remain fixed over time, inflation will increase the percentage of households who pay tax on benefits from 22 percent in 1995 to 30 percent in 1999.

Increasing the tax on benefits would reduce the net benefits of retirees compared with what some consider to be the implicit promises of the Social Security and Railroad Retirement programs at the time recipients were working. The government has, however, made numerous changes in the Social Security and Railroad Retirement programs over time, including changing the benefit formula, introducing partial taxation of benefits, and changing payroll tax rates to finance the programs.

Couples with incomes below $32,000 and individuals below $25,000 currently pay no tax on their benefits. Options one and two expand the population of beneficiaries subject to tax. Options one and three increase the fraction of benefits subject to tax from 50 percent to 85 percent for some taxpayers with combined incomes below $44,000 (couples) and $34,000 (single). A rationale for increasing the

percentage to 85 percent is to make the fraction of Social Security benefits that are taxable more similar to that of contributory private pension plans.

The first option would eliminate the income thresholds entirely and would require all beneficiaries to include 85 percent of their benefits in their adjusted gross income. In addition to the thresholds, the tax code protects lower-income elderly households from taxation of income through personal exemptions, the regular standard deduction, and an additional standard deduction for the elderly. Under current law, 78 percent of elderly couples and individuals with benefits pay no income tax on their benefits. Eliminating the thresholds on taxing benefits would raise nearly $100 billion from 1995 through 1999. In addition, it would reduce the share of couples and individuals paying no tax on their benefits to 30 percent.

Eliminating the thresholds would reduce tax disparities among middle-income households. Social Security beneficiaries receive a tax preference because they exclude a portion of their income--Social Security benefits less than or equal to the threshold amounts--from AGI, and taxpayers who are not Social Security recipients must include all of their income in AGI. As a result, the average income tax rate that middle-income elderly families pay is less than the tax rate that nonelderly families with comparable incomes pay under current law. At the same time, for a comparable deficit reduction, eliminating the thresholds would reduce the disposable incomes of the lower-income elderly less than would curtailing cost-of-living increases.

The second option would include 50 percent of benefits in adjusted gross income for couples with combined incomes below $44,000 and individuals with combined incomes below $34,000. Couples and individuals with incomes above these amounts would still include 85 percent of their benefits in adjusted gross income. In addition, almost all couples with combined incomes between $32,000 and $44,000 and individuals with combined incomes between $25,000 and $34,000 would be unaffected. (Because the taxation of benefits is phased in, some couples with combined incomes just above $32,000 and singles with incomes just above $25,000 would be affected.) Couples with combined incomes below $32,000 and individuals with combined incomes below $25,000 would be added to the beneficiaries whose benefits are subject to tax. This option would raise $48.3 billion from 1995 through 1999.

The final option would keep the current-law income threshold of $32,000 for couples and $25,000 for individuals, while including up to 85 percent of benefits for all taxpayers above this threshold. This option would almost exclusively affect couples with combined incomes between $32,000 and $44,000, and individuals with incomes between $25,000 and $34,000. The option would raise $4.1 billion from 1995 through 1999.

REV-13 PHASE OUT THE DEPENDENT-CARE CREDIT

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Phaseout Starting at:						
$30,000	0.1	1.4	1.5	1.6	1.6	6.2
$50,000	0.1	0.8	0.8	0.9	1.0	3.6
$65,000	a	0.4	0.5	0.5	0.6	2.0

SOURCE: Joint Committee on Taxation.

a. Less than $50 million.

Taxpayers who incur employment-related expenses for the care of children and certain other dependents may claim an income tax credit. The credit per dollar of qualifying expenses declines from 30 percent for taxpayers whose adjusted gross income (AGI) is $10,000 or less to 20 percent for taxpayers whose AGI is above $28,000. The tax law limits creditable expenses to $2,400 for one child and $4,800 for two or more. Creditable expenses cannot exceed the earnings of the taxpayer or, in the case of a couple, the earnings of the spouse with lower earnings. In 1991, taxpayers claimed about $2.5 billion in credits on 6 million tax returns.

About one-half of the credit benefits families with incomes of $50,000 or more. Retaining the credit only for lower-income families would reduce its revenue cost. One way to do this would be to reduce the percentage of credit as incomes rise. For example, reducing the credit percentage by 1 percentage point for each $1,500 of AGI more than $30,000 would raise about $6 billion from 1995 through 1999. This option would reduce the credit for about 51 percent of currently eligible families and would eliminate it for another 30 percent of these families (those with AGI over $58,500). Alternatively, phasing out the credit between $50,000 and $78,500 would raise about $3.6 billion in the same period. This option would reduce the credit for about 33 percent of eligible families and eliminate it for another 14 percent. Finally, phasing out the credit between $65,000 and $93,500 would raise $2 billion in the same period, reducing the credit for about 24 percent of eligible families and eliminating it for another 8 percent.

The credit provides a work incentive subsidy for families with children. Phasing out the credit for higher-income families targets that subsidy toward families with greater economic need, but may discourage parents in families with a reduced credit from working outside the home.

If the credit were phased out, higher-income employees could seek other tax benefits for dependent care by asking their employers to provide subsidized day care. Current law allows workers to exclude from taxable income up to $5,000 of annual earnings used to pay for dependent care through employer-based programs. To preclude taxpayers from using this alternative, the Congress could limit the use of this fringe benefit.

REV-14 TAX INVESTMENT INCOME FROM LIFE INSURANCE PRODUCTS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Tax Inside Buildup	4.2	10.3	9.7	9.0	8.3	41.5
Disallow Corporate Interest Deductions from Policy Loans	0.4	0.5	0.5	0.6	0.6	2.6

SOURCE: Joint Committee on Taxation.

Whole-life insurance is both an insurance policy and a tax-preferred savings plan. In the early years of a policy, a policyholder pays a premium greater than needed to fund the death benefit, with the excess payment earning interest that averts the need for larger premiums as the insured person ages. The investment income, called the "inside buildup," is either tax-free or tax-deferred, depending on the circumstances under which the life insurance company remits the income.

If the company pays a death benefit, the inside buildup is not taxable either to the beneficiary or, with some tax planning, to the estate of the insured person. When a policyholder voluntarily cancels a policy, he or she receives a disbursement called the "cash surrender value," which includes the accrued interest. This disbursement is taxable to the policyholder to the extent it exceeds his or her "basis" in the policy--that is, the cumulative premiums net of dividend and loan distributions. Even though the inside buildup is ultimately taxable in this case, deferral of the tax until cancellation of the policy confers a benefit to the policyholder.

Corporations can take advantage of inside buildup by taking out loans with the cash value of the policy as collateral. Corporations often purchase life insurance against the death of certain important employees. When corporations take out loans with the policy as collateral, a significant amount of the interest payments are tax deductible, even though the corresponding inside buildup is not taxable. This treatment provides a tax arbitrage opportunity in that corporations can generate interest deductions that they can use to shelter other taxable income. Individuals do not have that opportunity because they cannot deduct such interest payments. Corporations that pay the alternative minimum tax (AMT) receive only a limited tax arbitrage opportunity because they receive only a partial tax benefit from inside buildup. These corporations, therefore, tend not to purchase these insurance policies for tax purposes.

The Congress could raise revenue either by taxing the inside buildup accrued after January 1, 1995, on both new and existing policies or, more narrowly, by disallowing corporations from deducting the interest paid on loans with new or existing policies as collateral.

Tax Inside Buildup on Life Insurance Policies. This approach would make the rules for taxing interest on the savings components of whole-life insurance just like the rules for taxing interest from ordinary savings accounts. The proposal would define the savings component as the excess of the cash surrender value (the refund the policyholder receives upon canceling or outliving the policy) over the policyholder's investment in the contract. The policyholder's investment in the savings component is the difference between premiums paid in excess of the true cost of the insurance provided (determined from mortality tables) and any policy dividends and other distributions the policyholder receives. Making the annual changes in the savings component of policies taxable in that way would

raise $41.5 billion in 1995 through 1999. This estimate assumes the tax law is changed so that taxpayers are no longer permitted to exchange their whole-life insurance policies for deferred annuity policies, another tax advantaged instrument, without recognizing taxable gain on any inside buildup. Over the long term under this option, people would have a greater incentive to make new investments in deferred annuities, although this shift in investments has little effect on the revenue estimate for this option over the next five years.

The major reason for taxing the inside buildup within whole-life insurance policies is to make its treatment more similar to the investment income from other financial assets that is taxed currently. The savings within whole-life insurance and ordinary savings accounts, for example, are both easily accessible with a readily measured and steadily growing value. The income from ordinary savings accounts, however, is currently taxed. Thus, the tax benefit for whole-life insurance encourages people to switch funds from ordinary savings accounts to whole-life insurance policies. The revenue loss from the tax preference for inside buildup is growing rapidly because life insurance companies are selling more policies that have investment income as their primary goal. These policies contain just enough of a death benefit to qualify for the tax preference for life insurance.

Looked at a different way, inside buildup resembles the appreciation from homes and corporate equities. Like these assets, whole-life insurance is also typically a long-term investment with significant transaction costs. The insurance companies usually charge sizable fees to set up the policies. Investors can defer the tax on income from equities and homes until realization. An analogous rule would continue to allow the same deferral benefit for inside buildup.

Disallow Corporate Interest Deductions from Policy Loans. In the Tax Reform Act of 1986, the Congress restricted the size of a loan that qualifies for the interest deduction to $50,000 per insured employee. The Congress could expand on those restrictions by denying the deduction by corporations of interest from all policy loans, regardless of loan size. Denying these deductions would raise an estimated $2.6 billion in revenues over the next five years. The Bush Administration proposed this option in the budget for fiscal year 1993. The option is available as an alternative to taxing inside buildup directly.

To circumvent the restrictions that the Congress enacted in 1986, corporations have spread smaller policies over a larger group of employees. The widespread use of policy loans implies that the companies are making increasing use of life insurance contracts for investment purposes rather than as protection against the death of key employees.

Disallowing interest deductibility from loans on existing policies would adversely affect corporations that purchased contracts expecting to receive interest deductibility. To ease the transitional burden, the Congress could decide to restrict interest deductibility only for the loans from new policies. Such a limitation would reduce the revenue pickup significantly over the first five years, but it would not affect revenue in the long term.

REV-15 EXPAND MEDICARE AND SOCIAL SECURITY COVERAGE

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Expand Medicare Coverage to Include State and Local Government Employees Not Now Covered	1.2	1.6	1.6	1.5	1.5	7.4
Expand Social Security Coverage to Include All New State and Local Government Employees	0.4	1.2	1.7	2.3	2.9	8.5

SOURCE: Congressional Budget Office.

NOTE: These estimates do not include the effect of any increases in benefit payments that would result from the option. These would be small over this five-year period. Estimates are net of reduced income tax revenues.

Government workers remain the largest group of workers not paying Medicare and Social Security payroll taxes, even though legislation during the past decade mandated participation by certain groups of federal, state, and local government workers. This legislation required all federal workers to pay Medicare payroll taxes beginning in 1983 and required federal employees who began work after December 31, 1983, to pay Social Security payroll taxes. Further legislation mandated that state and local workers who began employment after March 31, 1986, must pay Medicare payroll taxes. The Omnibus Budget Reconciliation Act of 1990 expanded Social Security and Medicare coverage to include state and local government workers not covered by any retirement plan.

Under current law, many state and local employees will qualify for Social Security and Medicare benefits based on other employment in covered jobs or their spouses' employment. These workers will thus receive benefits in return for a smaller amount of lifetime payroll taxes than those paid by people who work continuously in covered employment. This inequity is especially apparent for Medicare benefits: one out of six state and local employees is not covered through his or her employment, but 85 percent of these employees receive full Medicare benefits through their spouse or because of prior work in covered employment. Inequitable treatment is less of a problem in the case of Social Security benefits because the benefit formula is adjusted for retired government workers who have worked a substantial portion of their careers in employment not covered by Social Security.

Requiring all state and local workers to pay Medicare payroll taxes, and all new state and local workers to pay Social Security payroll taxes, would make coverage of state and local workers resemble that of federal workers. This broader coverage would reduce the inequity from the high benefits these workers receive in relation to payroll taxes paid. Expanding Medicare and Social Security payroll taxes to include more state and local workers would increase the government's liability for future program benefits. The additional revenues, however, would more than offset increased benefits for a long time.

Expand Medicare Coverage to Include State and Local Government Workers Not Now Covered. Expanding Medicare coverage to include state and local government workers who began work before

April 1, 1986, would raise $7.4 billion from 1995 through 1999. The Administration has proposed this option in its health care reform package, and in recent years, the Congress has considered it during the budget reconciliation process.

Expand Social Security Coverage to Include All New State and Local Government Workers. Retirement coverage for state and local government workers may be provided by a public-employee program, the Social Security program, or a plan that integrates the two programs. Expanding Social Security coverage to include all new state and local government workers would raise $8.5 billion from 1995 through 1999, although in the long run higher Social Security benefit payments would offset the extra revenue. How states and localities revised their pension plans in response to mandatory coverage would determine which workers gained and lost from this change, but requiring coverage of new state and local government workers is likely to benefit many workers who spend only part of their careers in the government sector. First, because of the portability of coverage, newly hired workers would find it easier to qualify for disability and survivors' benefits under Social Security than under many public-employee benefit programs. Second, Social Security eligibility is not lost if the state and local employees change jobs before they are vested. Third, Social Security benefits are calculated on the basis of indexed wages, while benefits from public pension plans are calculated on the basis of nominal wages for a given amount of covered wages. Consequently, workers who worked only when they were young would receive more generous retirement benefits from Social Security than from public pension plans

State and local governments would have to pay the employer's share of Social Security taxes on new employees if coverage were made mandatory. Because state and local government participation in Social Security is now voluntary, those states with a low percentage of covered employees would bear more of the cost of expanded mandatory coverage, including the cost of setting up the system.

REV-16 TAX EMPLOYER-PAID HEALTH INSURANCE

Addition to CBO Baseline	1995	1996	1997	1998	1999	Cumulative Five-Year Addition
	Annual Added Revenues (Billions of dollars)					
Tax Some Employer-Paid Health Insurance						
Income Tax	6.5	10.2	12.5	15.0	17.8	62.0
Payroll Tax	4.5	7.0	8.6	10.2	12.1	42.4
Total	11.0	17.2	21.1	25.2	29.9	104.4
Tax All Employer-Paid Health Insurance, but Allow Individuals a Credit for Premiums They or Their Employers Pay up to a Limit						
Income Tax	27.2	4.3	7.1	10.3	13.8	62.7
Payroll Tax	25.8	36.6	39.7	42.9	46.1	191.1
Total	53.0	40.9	46.8	53.2	59.9	253.8

SOURCE: Joint Committee on Taxation

Employees do not pay taxes on income they receive in the form of employer-paid health insurance. In addition, health insurance premiums and health care costs paid through a cafeteria plan are generally excludable from income and payroll taxes. These exclusions will reduce income tax revenues and payroll tax revenues by a total of about $90 billion in fiscal year 1995. Limiting or modifying the tax exclusion represents an incremental approach toward some of the objectives for health policy stated by the President and Congressional reformers that could also reduce the deficit. Some comprehensive health policy proposals also include limits on the tax exclusion.

Tax Some Employer-Paid Health Insurance. One way to limit the exclusion would be to treat as taxable income for employees any employer contributions for health insurance plus health care costs paid through cafeteria plans that exceed $375 a month for family coverage and $175 a month for individual coverage. These amounts are estimated average amounts for 1995. The option would index these amounts to reflect future increases in the general level of prices. It would raise income tax revenues by about $62 billion and payroll tax revenues by about $42 billion over the 1995-1999 period. Including employer-paid health care coverage in the Social Security wage base, however, would lead to increased outlays on Social Security benefits that could offset most of the added payroll tax revenues from this option over the long run.

An advantage of this approach is that it would eliminate the tax incentive to purchase additional coverage beyond the ceiling. Without such coverage, there would be stronger incentives to economize in the medical marketplace, thereby reducing upward pressure on medical care prices and the provision of unnecessary or marginal services. Because the option indexes the ceiling amounts to the overall inflation rate, while health care costs have been rising faster than inflation, it could constrain health care costs even more over time. The Congress has already limited the exclusion for employer-paid group term life insurance in a similar way.

One disadvantage of limiting the tax exemption of employer medical insurance premiums is the difficulty of determining when extensive coverage becomes excessive. Also, a given premium pur-

chases different levels of coverage depending on such factors as geographic location and the characteristics of the firm's work force. As a result, a uniform ceiling would have uneven effects. Finally, if health insurance costs continue to rise faster than the general level of prices, indexing to reflect the general level of prices would gradually reduce subsidies for employer-paid health insurance. The result of all of these factors may be to increase the number of workers without health insurance.

Tax All Employer-Paid Health Insurance, but Allow Individuals a Credit for Premiums They or Their Employers Pay up to a Limit. Another option would treat all employer-paid health insurance premiums as taxable income and disallow payments for health care costs through cafeteria plans, but offer a refundable individual income tax credit of 20 percent for health insurance premiums up to the amounts described above for family and individual coverage. The credits would be available to taxpayers whether or not their employers paid for or sponsored the coverage. The option would increase income tax revenues by about $63 billion over the 1995-1999 period. This amount would be the net result of about $277 billion in revenues if there were no credit, less about $214 billion in new income tax credits. Payroll tax revenues would also rise substantially, by about $191 billion over the same period. As under the first option, however, in the long run, increases in Social Security outlays could offset most of the added payroll tax revenues.

In addition to eliminating the tax incentive for excessive health insurance, as under the first alternative, an added advantage of this option is that the subsidy would be available to all taxpayers who purchase health insurance, without regard to their employment status. Moreover, the subsidy per dollar of eligible health insurance premiums would no longer be relatively higher for taxpayers with higher marginal tax rates (and higher incomes). Limiting the amount of insurance eligible for credits to a fixed level, however, creates all of the same problems as in the first option. Moreover, by extending the subsidy to individual purchases of insurance, the option may induce relatively healthy employees to purchase insurance outside of the work place. Consequently, insurance would become more expensive for the remaining employees, especially at small firms, and this rise in cost could cause more firms to terminate coverage.

REV-17 TAX A PORTION OF THE INSURANCE VALUE OF MEDICARE BENEFITS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
			With Income Thresholds			
Hospital Insurance Only	1.7	4.6	5.3	6.3	7.3	25.2
Supplementary Medical Insurance Only	1.2	3.2	3.9	4.8	5.9	19.0
Both	3.1	8.3	10.0	12.0	14.4	47.8
			Without Income Thresholds			
Hospital Insurance Only	2.5	8.6	9.7	11.0	12.4	44.2
Supplementary Medical Insurance Only	1.6	5.7	6.8	8.1	9.7	31.9
Both	4.5	15.6	18.1	21.1	24.5	83.8

SOURCE: Joint Committee on Taxation.

Like Social Security, Hospital Insurance (HI) benefits under Medicare are financed by payroll taxes, which are earmarked for a trust fund. Social Security benefits, however, are partially taxable for higher-income people, whereas the value of HI is not subject to tax. In addition, the Supplementary Medical Insurance (SMI) component of Medicare is heavily subsidized; only about 25 percent of the benefits paid are covered by premiums. This option would make the taxation of HI conform to current law and the tax option for Social Security in REV-12 and would partially tax SMI.

The first option would treat the insurance value of Medicare like Social Security benefits, although the tax would be imposed on the average insurance value of in-kind Medicare benefits, not on the dollar value of benefits actually received. In this option, 85 percent of the value of HI and 75 percent of the value of SMI would be included in adjusted gross income (AGI) for taxpayers with combined income (AGI plus nontaxable interest income plus one-half of Social Security, Railroad Retirement, and Medicare benefits) over $34,000 for single returns and $44,000 for joint returns. For taxpayers with combined incomes below these thresholds, but above $25,000 (single) and $32,000 (joint), 50 percent of the value of Medicare health insurance would be included in AGI. Taxpayers with lower incomes would have no additional tax liability. Because the thresholds are fixed, inflation will cause a larger fraction of Medicare insurance benefits to become taxable over time.

With these income thresholds, the HI tax alone would increase federal revenues by about $25 billion from 1995 through 1999. The SMI tax alone would yield $19 billion over the five-year period. If both taxes were imposed simultaneously, revenues would be nearly $48 billion higher over five years. The combined tax would generate more revenues than the sum of the HI and SMI taxes because some taxpayers would be subject to higher tax rates as a result of the increase in AGI. In addition, more enrollees exceed the threshold when both components are included in combined income.

The second option would include 85 percent of the insurance value of HI benefits and the subsidy component of SMI (about 75 percent) in AGI for all taxpayers. Without an income threshold, the HI tax alone would increase federal revenues by about $44 billion over the 1995-1999 period. Revenues from the SMI tax alone would be nearly $32 billion over

the five-year period. If both taxes were imposed simultaneously, revenues would be almost $84 billion higher over the five-year period.

If the tax on HI benefits were earmarked for the HI trust fund, it would delay the projected deficit of the trust fund in 2003. A tax on SMI benefits would shift some SMI costs from taxpayers to enrollees. If income thresholds were used, lower-income enrollees would not be affected. In fact, only about 60 percent of enrollees in 1995 would be affected by this proposal even if no income thresholds were used. Furthermore, since this option would use the mechanism already in place for taxing Social Security benefits, it would be straightforward to administer.

Unlike the tax on Social Security benefits, this tax would be imposed on the insurance value of in-kind benefits rather than on the dollar benefits actually received. Some people might object that the additional income does not generate cash with which to pay the tax liability. (There would be little to recommend basing the tax on actual benefits received, however, because it would then be directly related to enrollees' health care costs. Such a tax would reduce the insurance protection Medicare is intended to provide.) In addition, the actual value of insurance provided under Medicare varies among households based on age, health status, and whether they have other health insurance.

Thus, including a fixed imputed HI premium in income may be viewed as unfair. The approximately 13 percent of enrollees in or above the 28 percent tax bracket would face a tax increase averaging $1,170 in 1995 for individuals and about $2,350 for couples with two enrollees, assuming the combined tax was imposed with no income thresholds. In addition, more households would have to pay tax on Social Security benefits if the definition of combined income were expanded to include Medicare benefits.

REV-18 CURTAIL TAX SUBSIDIES FOR EXPORTS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	2.6	4.6	4.9	4.8	4.9	21.8

SOURCE: Joint Committee on Taxation.

The tax code subsidizes U.S. exports in two important ways. First, the allocation of income between domestic and foreign business activities under the "title passage" rule routinely allows U.S. multinational companies to use excess foreign tax credits to offset about half of the U.S. tax on their export income by characterizing it as foreign-source income. Second, the tax rules for foreign sales corporations (FSCs) offer U.S. companies an opportunity to exempt about 15 percent of their export income from U.S. tax by characterizing it as income of a foreign subsidiary that is not effectively connected with U.S. trade or business.

Sourcing Rules for Sales of Inventory. U.S. companies generally pay U.S. tax on their worldwide income, but they may claim a foreign tax credit. The foreign tax credit reduces the tax that U.S. companies owe on foreign-source income by the amount of income tax they pay abroad. To prevent the foreign tax credit from offsetting domestic-source income, the tax code limits the credit to the amount of tax owed on foreign-source income. When foreign tax payments exceed the U.S. tax on foreign-source income, U.S. companies accrue excess foreign tax credits that they cannot currently use. U.S. companies retain these excess credits to offset taxes owed on future income from foreign sources, but only for five years. (One consequence of lowering corporate tax rates in the Tax Reform Act of 1986 is that more U.S. multinational companies are accumulating excess foreign tax credits that are likely to expire.)

In allocating worldwide income between domestic and foreign sources, sourcing rules determine how fully U.S. companies can use their foreign tax credits to reduce their U.S. tax liability. For example, when a corporation has excess foreign tax credits, treating a dollar of income as foreign-source income instead of domestic-source income allows the corporation to use excess credits that might otherwise expire to reduce the U.S. tax on its worldwide income by about 35 cents.

Sales income is classified for tax purposes as domestic or foreign source according to a complex set of sourcing rules that take account of the residence of the seller, the place of sale, the location of the seller's business activities, and the presence of any foreign tax on the sales income. Under a particular rule known as the "title passage" rule, the income of a U.S. company from the sale of inventory is sourced according to the place of sale. So when inventory is sold abroad, the income from the sale is deemed foreign-source income, regardless of where the inventory was purchased and regardless of whether the income was subject to foreign tax. When a U.S. company produces the inventory in the United States and markets it abroad, half of the income is typically classified as foreign source on the basis of the title passage rule and half is classified based on the location of the production activity. Assuming the company has excess foreign tax credits to offset the tax on its foreign-source income, the 50-50 allocation effectively exempts half of the export income from U.S. tax.

If the title passage rule allows a company with excess foreign tax credits to classify more of its export income as foreign source than it could justify solely on the basis of the location of its business

activities, the company receives an implicit export subsidy.

Foreign Sales Corporations. According to a decision by the governing council of the General Agreement on Tariffs and Trade (GATT), export income can be exempt from U.S. tax only if the economic activity that produces the income takes place outside the United States. In response to the GATT decision, the tax code was amended by the Congress to allow U.S. companies to charter FSCs in low-tax countries and either supply goods to the FSCs for resale abroad or pay commissions to FSCs on export sales. Although the FSCs are largely paper corporations with very few employees, the Congress believes that they have enough foreign presence and economic substance to meet GATT's requirements to exempt export income.

Under the tax code, when a U.S. company sells exports through an FSC, about 23 percent of the total income from production and marketing is attributed to the FSC and fifteen-twenty-thirds of the FSC's export income is exempt from U.S. tax. The exempt income, which is approximately 15 percent of the income from the sale, remains free from U.S. tax when the U.S. company receives it as a dividend from the FSC.

Economic Effects of Export Subsidies. Export subsidies increase investment and employment in export industries, but do not increase the overall levels of domestic investment and domestic employment. Stimulating exports increases the demand for U.S. dollars by foreigners, which raises the value of the dollar and lowers the cost of imports, causing imports to increase. In the long run, export subsidies increase imports as much as exports, which causes investment and employment in import-competing industries in the United States to decline about as much as they increased in the export industries.

Export subsidies reduce domestic welfare by distorting the allocation of economic resources at home and abroad. The subsidized production of export goods in the United States partially displaces the more efficient production of these goods abroad. Moreover, the subsidies increase the worldwide supply of goods that the United States exports and decrease the worldwide supply of goods that the United States imports. The shifts in supply lower the world price of U.S. exports and raise the price of U.S. imports. As a result, domestic welfare suffers because the United States receives fewer import goods in exchange for its export goods.

Curtailing the export subsidies provided by the title passage rule and the favorable tax treatment of FSCs would raise about $22 billion from 1995 through 1999. The option would curtail the export subsidy from the title passage rule by eliminating it and treating the income of U.S. companies from the sale of goods abroad as domestic-source income. An exception would be allowed, however, if a U.S. company had a place of business that was located outside of the United States and was substantially involved in the export sale. Under the exception, income would be allocated between domestic and foreign sources based on the location of the business activities that produced the income. The option would curtail the subsidy from FSCs by treating them like other foreign subsidiaries. In general, all of the income repatriated from FSCs would be subject to U.S. tax, but some of it might be foreign-source income under the revised sourcing rule mentioned above. The tax on any income from the FSC that was deemed foreign-source income could be offset by unused foreign tax credits.

REV-19 IMPOSE A MINIMUM TAX ON FOREIGN-OWNED BUSINESSES

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	0.2	0.3	0.5	0.7	0.9	2.6

SOURCE: Joint Committee on Taxation

Foreign-owned companies must pay tax on the income they earn from business activities within the United States. Treaties with other countries generally stipulate that the United States will not tax the income of foreign-owned businesses more heavily than the income of U.S.-owned businesses.

When foreign multinational corporations operating in the United States import materials and services from affiliated companies abroad, the "transfer price" of imports affects the amount of income that is subject to U.S. tax. (The transfer price is the price charged for goods sold between affiliated companies.) By raising the transfer price of imports, foreign-owned companies can shift income out of the United States to their foreign affiliates and reduce their U.S. tax liability. U.S. tax law requires companies to base the transfer prices of many goods and most services on comparable transactions between unaffiliated companies. But such prices are often difficult for companies to determine and even more difficult for the Internal Revenue Service (IRS) to enforce, especially when comparable goods and services are not routinely traded between unaffiliated companies.

Foreign-owned multinational corporations may be manipulating transfer prices to shift income overseas and avoid U.S. tax. There is circumstantial evidence that this kind of tax avoidance has occurred. For example, studies have found that the reported profit rates (as a percentage of assets and as a percentage of sales) of foreign-owned multinational corporations operating in the United States are generally lower than the profit rates of U.S.-owned corporations in the same industry. However, there are other plausible explanations for the low profit rates. For example, foreign-owned companies may have newer plants and equipment than U.S.-owned companies in the same industry. Because accelerated depreciation methods allow companies to claim larger annual deductions on newer equipment than on older equipment, foreign-owned companies would have higher reported depreciation costs and lower reported profit rates as a percentage of sales. Moreover, because the absence of an inflation adjustment for the book value of plant and equipment undervalues older assets relative to newer assets, U.S.-owned companies with older assets would tend to have higher profit rates as a percentage of reported book value than foreign-owned companies with newer assets.

To discourage foreign companies from manipulating transfer prices to avoid U.S. tax, a minimum tax could be levied on foreign-owned businesses that have a sizable amount of trade with affiliated companies overseas. One legislative provision, introduced in 1992, would have imposed a minimum tax on all companies that are at least 25 percent foreign owned and have transactions with foreign affiliates in excess of either 10 percent of their gross income or $2 million annually. Under the proposal, the foreign-owned company would compute its taxable income under the current income tax rules, but its taxable income would be subject to a floor. The floor would equal 75 percent of its gross business receipts multiplied by the average profit margin on gross receipts for U.S. companies in the same industry. If the foreign-owned company's operations spanned several industries, the floor would be based on the profit margins in each industry weighted by the company's gross receipts in the industry. The IRS could waive the minimum tax

after examining a company's method of computing transfer prices and finding it acceptable.

The formula approach under the minimum tax provides a simple way to ensure that foreign-owned companies conducting business in the United States pay an acceptable amount of U.S. tax. The simplicity of the approach may offer some advantage over the cumbersome rules for arm's-length pricing, which are extremely difficult to enforce. The formula approach, however, provides a very crude estimate of taxable profit.

The minimum tax would discriminate against foreign-owned companies, possibly in violation of U.S. treaties, by taxing their income more heavily than the income of their domestic competitors. The minimum tax would be especially onerous on foreign-owned companies starting new businesses in the United States because new businesses are seldom profitable initially. Under the minimum tax, such businesses would still owe a sizable amount of income tax based on their gross receipts.

Other countries are likely to treat the minimum tax as a protectionist measure and retaliate with similar taxes on U.S.-owned companies conducting business within their borders. If so, then the minimum tax would stifle international trade and reduce economic welfare throughout the world. Imposing the minimum tax on foreign-owned companies would raise $2.6 billion from 1995 through 1999.

REV-20 TAX CAPITAL GAINS FROM HOME SALES

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Tax 30 Percent of Gain	1.2	5.0	5.1	5.3	5.5	22.1
Tax Lifetime Gains in Excess of $125,000	0.1	0.3	0.3	0.3	0.4	1.4

SOUR[illegible] [illegible]t Committee on Taxation.

When homeowners sell their home, they realize a capital gain or loss equal to the difference between the selling price and their basis. Their basis is the initial cost of the home plus the cost of home improvements.

Although capital gains on most assets are taxable when sold, capital gains on home sales generally escape taxation. A taxpayer can defer the capital gain from the sale of a principal residence if she or he purchases another home of at least equal value within two years. When a homeowner dies, the accrued gain on the current home plus any gain on previous homes escapes tax permanently. Further, the tax law allows taxpayers age 55 and older to exclude up to $125,000 of gain from one home sale even if they do not purchase another home of equal or greater value within two years. Replacing the above provisions with a rule that includes 30 percent of capital gains from home sales in taxable income would raise about $22 billion in 1995 through 1999. Alternatively, including all lifetime gains in excess of $125,000 in taxable income when realized would raise $1.4 billion over the same period.

The preferential treatment of capital gains from home sales is only one of the ways in which the tax code strongly favors owner-occupied homes over other investments (for a discussion of other ways, see REV-04). All of these tax preferences divert savings from business investment to housing. One way to make the tax treatment of housing more like that of other assets would be to replace the capital gains deferral and exclusion provisions with a low-rate tax on gains from home sales. Including 30 percent of the gain from home sales in taxable income would make the tax rate on such gains range from 4.5 percent for taxpayers facing a 15 percent marginal tax rate to 11.9 percent for those in the 39.6 percent tax bracket.

A tax on gains from home sales would discourage home sales in the same way that current law discourages taxpayers from selling other capital assets. In the case of home sales, that might discourage workers from relocating to take advantage of better job opportunities. The tax might also deter some homeowners (especially older taxpayers with large accrued gains) from changing homes as family requirements change.

Another option would allow all taxpayers to exempt the first $125,000 of gains on all home sales from tax, while fully taxing the excess over this amount at the time of sale. This option would protect the mobility of most homeowners. Taxpayers who realize a gain of less than $125,000 on their first home could apply the unused portion to future home sales. This exclusion would increase the mobility of homeowners under age 55 relative to current law because they could move to homes of lesser value without incurring a tax as long as the gain on the home they sold was less than $125,000. Although this proposal would increase mobility for most homeowners, it would reduce it for those under age 55 whose gains from home sales exceed $125,000. These taxpayers could no longer defer additional gain by purchasing a larger home.

Taxing gains on home sales without the rollover and exclusion that current law allows would increase the need for taxpayers to keep records on home improvements. They need to maintain these records to establish the tax basis of a home upon sale. Currently, many taxpayers do not keep such records because the probability of any future tax on gains from a home sale is low and the expected present value of such a tax is small. Allowing a lifetime exemption of $125,000 would complicate recordkeeping, especially when people buy and sell successive homes with different spouses.

Much of the capital gain on home sales results from inflation. Inflationary gains are not income and therefore ideally would not be subject to income taxation. Taxing inflationary gains may, however, be an appropriate way to offset the tax benefit homeowners enjoy from inflation by being able to deduct fully their mortgage interest payments, which include an inflation premium.

Any reduction in the tax benefit from home ownership would lower the value of existing housing relative to other assets such as corporate equity. The loss in value would be felt most by middle-income taxpayers because homes are their principal asset.

As a way of reducing the tax benefit to home ownership, the primary alternative to taxing gains on sale is to limit the mortgage interest deduction (see REV-04). Limiting the mortgage interest deduction has the advantages of not hindering mobility or complicating recordkeeping. Taxing gains on sale, however, has the advantage of preserving the greatest tax break for first-time homebuyers.

REV-21 TAX CAPITAL GAINS HELD UNTIL DEATH

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Include Gains in the Last Income Tax Return of Deceased[a]	b	8.1	8.6	9.0	9.5	35.2
Enact Supplemental 10 Percent Estate Tax	b	0.8	0.9	0.9	1.0	3.6
Enact Carryover Basis	b	0.8	1.7	2.7	3.8	9.0

SOURCE. Joint Committee on Taxation.

a. Estimate is net of reduced estate tax revenues.

b. Less than $50 million.

A capital gain or loss is the difference between the current value of an asset and the owner's basis. The owner's basis is the initial cost of the asset plus the cost of any subsequent improvements and minus any deductions for depreciation. When an asset is sold, the tax law normally requires that the owner include any realized gain in taxable income. The owner can deduct any realized loss against realized gains, and when the owner does not have gains in excess of losses, he or she can deduct up to $3,000 of the loss against other income.

An exception occurs when an owner holds an asset until death. In this case, the tax law allows the beneficiary to "step up" the basis to the asset's value as of the date of the decedent's death. When the beneficiary subsequently sells the asset, he or she pays tax on the gain that accrued after the decedent's death. The gain that accrued before the decedent's death is permanently excluded from taxable income. The estate of the decedent may pay taxes under the separate estate tax, but this tax applies equally to assets on which the decedent previously paid income tax and to assets with accrued capital gains that had escaped income taxation.

There are three ways of taxing gains held at death: the law could require that gains held at death be included as income on the final income tax return of the decedent, the estate of the decedent could be subject to a supplemental tax rate on accrued gains, or the law could require that beneficiaries assume the decedent's basis in the asset they inherit. Under this last method of carryover basis, the beneficiaries would include the decedent's unrealized gain in their taxable income when they sell the asset.

Tax Gains on Final Return of the Decedent. Taxing accrued but unrealized gains on the final income tax return of the decedent would raise $35.2 billion from 1995 through 1999. This option would exclude gains on assets that a spouse inherits. Instead, the spouse would assume the basis of the decedent and pay tax on the full gain only if the spouse sells the asset. Any gains on assets that the decedent leaves to charity would also be exempt. The option would include gains on other assets in taxable income. It would also allow three additional modifications. First, to ease the problem of documenting the basis, the option would allow the estate

to use an alternative basis equal to one-half of the asset's current value in computing the gain to be included on the final tax return. Second, the estate could claim the existing $125,000 exclusion on the gain from the sale of a principal residence if the decedent had not already claimed it. Third, the estate could exclude an additional $75,000 of any remaining gains. With all of these provisions, about one-tenth of the people who hold accrued gains when they die would pay taxes on those gains. Finally, taxes paid on gains realized at death would be deductible under the estate tax.

Tax Gains Under the Estate Tax. An additional estate tax on accrued gains of 10 percent would raise $3.6 billion from 1995 through 1999. This option would apply a flat 10 percent rate to the same tax base as in the previous option. In addition, however, taxpayers could offset the additional tax with any unused credits under the estate tax. Because of these credits, few people would owe additional tax under this option. Only about 1 percent of estates currently pay the estate tax and the fraction paying the additional tax on gains would be about the same.

Tax Gains Upon Realization by Heirs (Carryover Basis). A third option would carry over the decedent's basis in assets left to the heirs and tax the gains of the decedent when the heirs sell their assets. This option would raise $9 billion from 1995 through 1999. The option would also allow heirs to set the basis of inherited assets at one-half of their current value. In addition, if the estate of the decedent paid any estate tax, shares of that tax would be added to the basis of all the estate's assets in proportion to their shares of the estate's value. Carryover basis would make most gains held at death taxable, but the timing of the tax payments would depend on when the heirs sell the inherited assets.

Gains held until death have always been exempt from income tax. The Congress enacted a carryover basis in the Tax Reform Act of 1976 but postponed it in 1978 and repealed it in 1980. It was never in effect.

Taxing accrued gains at death, on either the last income tax return or the estate tax, would reduce the incentive for investors to hold assets until death in order to avoid tax. Current law encourages taxpayers to hold on to assets longer than they otherwise would. This "lock-in" effect distorts their investment portfolios and may hinder the flow of capital to activities with higher rates of return. Reducing the lock-in effect is one of the advantages of reducing the income tax on realized capital gains. Taxing gains at death would also reduce the lock-in effect, but, unlike a lower capital gains tax rate, it would reduce the preferential treatment of capital gains over ordinary income.

Using carryover basis would not achieve the same unambiguous reduction of the lock-in effect that the other two options would achieve. Using a carryover basis lessens the incentive for the original owner to hold on to an asset until death. But an heir receiving an asset with a carryover basis has a stronger incentive to hold on to the asset than under current law.

A disadvantage of taxing gains at death is that the tax might force the family of the decedent to sell assets to pay the tax, although two of the three options minimize this problem. Forced sales of illiquid assets at an inopportune time can reduce their value substantially. Forcing heirs to sell a family farm or business would impose a particular hardship on families wanting to continue the enterprise. Forced sales would not occur if a carryover basis were used because heirs could defer the tax on unrealized gains until they sell the assets. In addition, taxing gains held at death through the estate tax would also reduce forced sales because the estate tax permits heirs who continue to operate a family farm or business to defer payment for five years and then spread payment over the next 10 years. Estates would receive no deferral, however, if gains were taxed on the final income tax return of the deceased. If this option were instead structured to allow the estate to value a family farm or businesses on its current use instead of by its market value, as is currently allowed under the estate tax, then this option would allow a deferral and would raise less revenue than cited.

Taxpayers and the Internal Revenue Service often have difficulty determining the basis of assets of closely held businesses, personal property, and assets for which the taxpayer did not keep adequate

records. The difficulty in determining the amount of the basis was one of the main arguments that influenced the Congress to delay implementing carryover basis in 1978 and then to repeal it in 1980. Because people currently planning to hold assets until death might not have kept adequate records, documenting the basis would be particularly difficult immediately after passage of a law to tax gains held until death. Once a tax on gains held at death had taken effect, however, people would have a reason to keep better records. In the interim, allowing estates and heirs to set the basis at one-half of the market value at the time of death would ease compliance. Finally, if gains held at death were taxable under the estate tax instead of the income tax, most taxpayers would be exempt because of the high estate tax credit (see REV-22).

REV-22 INCREASE ESTATE AND GIFT TAXES

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Reduce the Unified Credit	a	3.0	3.5	4.1	4.8	15.4
Convert the Credit for State Death Taxes into a Deduction	a	0.5	0.6	0.7	0.7	2.5
Include Life Insurance Proceeds in the Base	a	0.2	0.3	0.3	0.3	1.1

SOURCE: Joint Committee on Taxation.

a. Less than $50 million.

Current law imposes a gift tax on transfers of wealth during a taxpayer's lifetime and an estate tax on transfers at death. The estate and gift taxes together constitute a unified tax: one progressive tax is imposed on cumulative transfers during life and at death. Generous credits built into the system, however, exempt most estates from taxation; about 25,000 estates paid tax in 1991.

The estate and gift tax rates in 1995 will range from 18 percent on the first $10,000 of transfers to 55 percent on transfers of more than $3 million, but a unified credit of $192,800 effectively exempts the first $600,000 from taxation. As a result of the credit, taxable estates face an initial tax rate of 37 percent on the first $150,000 of transfers in excess of $600,000. An additional 5 percent surcharge applies to estates between $10 million and $18.34 million. The 5 percent surcharge phases out the benefit of graduated rates for these larger estates. In addition, current law phases out the unified credit for estates above $10 million. Another credit allows taxpayers to subtract a portion of state death taxes from federal estate tax liability.

In the Omnibus Budget Reconciliation Act of 1993, the Congress made permanent the top two estate tax rates that had been scheduled to decline to 50 percent after 1992. These are the 53 percent rate that applies to estates of between $2.5 million and $3 million and the 55 percent rate that applies to estates of more than $3 million. The Congress could raise the estate and gift tax, without raising rates, by reducing allowable credits or by including proceeds of life insurance policies in the tax base.

Reduce the Unified Credit. Lowering the unified credit from $192,800 to $87,800 would raise $15.4 billion from 1995 through 1999 and make an additional 80,000 estates subject to tax. This lower credit is equivalent to an exemption of only the first $300,000 of transfers, instead of the current $600,000.

The estate and gift tax reduces the extent to which concentrations of wealth can be perpetuated. Taxing these concentrations, along with other programs to aid the less fortunate, increases the equality of opportunity for members of each new generation. The tax may also slow economic growth, however, by discouraging the accumulation of large estates.

The estate and gift tax provides the only tax on the unrealized capital gains held until death by people with the highest-valued estates. The estate and gift tax, however, taxes these unrealized gains at the same rate as other accumulated wealth that has already been taxed as income when earned (see REV-21).

Reducing the unified credit would extend the tax to more estates with small businesses, family farms, and large homes. The necessity of paying the tax would put pressure on heirs to sell these assets when they might prefer to retain them in the family, or when the value of the assets is temporarily depressed. The estate tax has provisions for spreading payment over 15 years for small businesses and family farms, but even this burden could be prohibitive for retaining some family assets. Reducing forced liquidation of assets was one concern of the Congress when it voted in 1981 to raise the credit from $47,000 to $192,800.

Convert the Credit for State Death Taxes into a Deduction. Currently, state death taxes reduce federal tax liability by a credit that ranges from 0.8 percent on transfers of $40,000 to 16 percent on transfers of more than $10 million. When implemented in 1926, the credit could virtually eliminate federal tax liability because the top marginal rate on estate and gifts taxes was 20 percent. The credit acts as a state revenue-sharing system for estates taxed up to the 16 percent exclusion level. Consequently, a majority of states have adopted death tax systems that simply redistribute estate tax revenues from the federal to state governments. This shift is accomplished by imposing state taxes that exactly match the amount of the federal credit. Changing the state death tax credit to a deduction would raise $2.5 billion from 1995 through 1999 and would correspond to the itemized deduction that taxpayers receive for state and local income and property taxes.

An alternative change that yields about the same revenue is to reduce the amount of state tax credited by half so that the maximum credit is 50 percent of the amount paid to states. The two alternatives are not equivalent for estates of different sizes. The value of the deduction increases as the marginal tax rate rises, while the value of the credit is not affected by the marginal tax rate.

Include Life Insurance Proceeds in the Base of the Estate and Gift Tax. Life insurance is an alternative way of transferring wealth to descendants, but is currently exempt from the estate tax if the policyholder is someone other than the person who died. Making life insurance proceeds subject to estate and gift tax would raise $1.1 billion from 1995 through 1999.

REV-23 AMORTIZE A PORTION OF ADVERTISING COSTS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	3.3	5.9	4.5	2.9	1.7	18.3

SOURCE: Joint Committee on Taxation.

The income tax law allows taxpayers to deduct the ordinary costs of doing business when they incur them. At the same time, it requires taxpayers to capitalize expenditures to purchase assets with useful lives that extend beyond the current tax year. They may then deduct capital costs at prescribed rates as the assets wear out in order to match costs with income. Taxpayers may deduct advertising as an ordinary business cost.

Because advertising often contributes to brand recognition that may last for years, capitalizing a portion of advertising costs and deducting it over several years might improve the matching of business costs with income. Requiring 20 percent of all advertising costs to be capitalized and deducted on a straight-line basis over four years would raise $18.3 billion from 1995 through 1999.

Because advertising is not always easy to identify, this option would require complex rules to distinguish advertising costs from other ordinary business costs. Some costs, such as those of notifying customers of price changes, redesigning product packaging, or changing store displays, might or might not fit within the definition of advertising. Moreover, because the useful life of advertising depends on its unknown effect on customers, any amortization rate would be arbitrary.

Amortizing a portion of advertising costs would raise the after-tax cost of advertising and discourage its use. To the extent that advertising is socially wasteful, causing consumers to change their preferences for essentially identical products, discouraging it could increase economic efficiency. However, advertising is socially useful when it gives customers a wider choice of products by promoting real product diversity.

REV-24 REDUCE TAX CREDITS FOR REHABILITATING OLDER BUILDINGS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Repeal Credit for Nonhistoric Structures and Reduce Credit for Historic Structures to 15 Percent	a	0.1	0.1	0.1	0.1	0.4
Repeal Both Credits	0.1	0.2	0.2	0.2	0.2	0.9

SOURCE: Joint Committee on Taxation.

a. Less than $50 million.

The Congress enacted tax credits for rehabilitation to promote the preservation of historic buildings, encourage businesses to renovate their existing premises rather than relocate, and encourage investors to refurbish older buildings. The credit rate is 10 percent for expenditures on commercial buildings built before 1936, and 20 percent for commercial and residential buildings that the Department of the Interior has certified as historic structures because of their architectural significance.

The credits favor commercial use over most rental housing and may, therefore, divert capital from more productive uses. Moreover, in favoring renovation over new construction, the credits may encourage more costly ways of obtaining additional housing and commercial buildings.

Rehabilitation may have social benefits to the extent that it discourages the destruction of historically noteworthy buildings. The government could promote this objective at a lower cost, however, by permitting a credit only for the renovation of certified historic buildings and lowering the credit rate. Some surveys have indicated that a 15 percent credit would be sufficient to cover the extra costs of both obtaining certification and undertaking rehabilitation of historic quality. Reducing the credit for historic structures to 15 percent and repealing the credit for nonhistoric structures would increase revenues over the 1995-1999 period by about $0.4 billion. Repealing both credits would raise about $0.9 billion over the same period.

REV-25 TAX CREDIT UNIONS LIKE OTHER THRIFT INSTITUTIONS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Tax All Credit Unions	0.7	0.7	0.7	0.8	0.8	3.7
Tax Credit Unions with More Than $10 Million in Assets	0.6	0.7	0.7	0.7	0.7	3.4

SOURCE: Joint Committee on Taxation.

Credit unions are nonprofit financial institutions that retain income on behalf of their members either as protection against unexpected events or as a source of financing expansion. The federal income tax treats credit unions more favorably than competing thrift institutions, such as savings and loan institutions and mutual savings banks, by exempting their retained earnings from tax. As a result, more credit unions and fewer taxable thrifts exist than would otherwise be the case. This reduces economic efficiency to the extent competing institutions might otherwise provide the same services at lower cost.

Credit unions, savings and loans, and mutual savings banks were originally all tax-exempt, but in 1951 the Congress removed the tax exemptions for savings and loans and mutual savings banks. It considered them to be more like profit-seeking corporations than nonprofit mutual organizations.

Since 1951, credit unions have come to resemble those other thrift institutions in certain respects. Credit unions no longer limit membership to people sharing a common bond, which has usually been employment. Since 1982, the regulators have allowed credit unions to extend their services to others, including members of other organizations. In addition, most credit unions allow members and their families to participate permanently, even after members have left the sponsoring organization. Credit union membership has grown from about 5 million in 1950 to about 65 million today. This leap in numbers is evidence that credit unions, like taxable thrifts, now serve the general public. Moreover, credit unions are becoming more like savings and loans and mutual savings banks in the services they offer. A significant number of credit unions now offer such services as first and second mortgages, direct deposit, automatic teller access, preauthorized payments, credit cards, safe deposit boxes, and discount brokerage services.

Many smaller credit unions, however, retain the characteristics of nonprofit mutual organizations and perhaps should not be subject to taxation. For instance, only volunteers from the membership manage and staff some of these credit unions. Moreover, these smaller credit unions often do not expand their membership beyond their immediate common bond or provide services comparable to competing thrift institutions. In order to protect these smaller credit unions, the Congress may choose to exempt from taxation those credit unions with assets below $10 million. Such an action would exempt about 70 percent of all credit unions from taxation, although they hold only about 10 percent of all credit union industry assets.

Taxing all credit unions like other thrift institutions would raise $3.7 billion in 1995 through 1999. Taxing only credit unions with assets above $10 million would raise about $0.3 billion less.

REV-26 REPEAL TAX PREFERENCES FOR EXTRACTIVE INDUSTRIES

Addition to CBO Baseline	Annual Added Revenue (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Repeal Expensing of Intangible Drilling, Exploration, and Development Costs	0.9	1.5	1.4	1.2	1.1	6.1
Repeal Percentage Depletion	0.6	1.0	1.1	1.1	1.1	4.9

SOURCE: Joint Committee on Taxation.

Under the normal tax rules for cost recovery, taxpayers cannot immediately deduct purchases of capital assets such as plant and equipment from taxable income. Instead, they must capitalize the purchase price and then deduct the cost at a prescribed rate over the asset's useful life either by depreciation or depletion. These rules also apply to assets that the user constructs instead of purchasing (self-constructed assets). Although oil and gas wells and mineral mines are self-constructed assets, they benefit from special cost-recovery rules. Taxpayers may immediately deduct (expense) certain exploration and development costs, including intangible drilling costs. Under general income tax rules, these costs would otherwise have to be capitalized and deducted more slowly.

Expensible exploration and development costs include costs for excavating mines and drilling wells. They also include prospecting costs for hard minerals, but not for oil and gas. Current law limits expensing to 70 percent of these costs for corporations engaged in extracting hard minerals and for integrated producers of oil and gas who also operate sizable refineries. These corporations may deduct the remaining 30 percent of costs over a 60-month period.

The percentage depletion method of cost recovery allows taxpayers to deduct a certain percentage of a property's gross income, regardless of the actual capitalized costs. Current law allows nonintegrated oil and gas companies to deduct 15 percent of the gross income from oil and gas production up to 1,000 barrels per day. (In contrast, integrated oil and gas producers must use the normal method of cost depletion to recover capitalized costs.) Producers of hard minerals may also use percentage depletion, but the statutory rates vary. Minerals eligible for percentage depletion include sand (5 percent), coal (10 percent), iron ore (14 percent), dimension stone and mollusk shells (14 percent), oil shale (15 percent), gold (15 percent), and uranium (22 percent). The tax law limits the amount of percentage depletion to 100 percent of the net income from an oil and gas property and 50 percent of the net income from a property with hard minerals.

Because percentage depletion depends on the value of production rather than the amount of capitalized costs, it is more akin to a production subsidy than a method of cost recovery. The subsidy provides little or no incentive to develop or expand production from marginal properties, however, because the amount of percentage depletion cannot exceed net income. Because marginal properties that are more costly to develop produce less net income, their percentage depletion deductions per dollar of gross income are smaller.

Percentage depletion and the expensing of exploration and development costs encourage oil and gas production and extracting hard minerals, but the incentives are not available to all producers on an equal basis. Integrated oil and gas producers may not claim percentage depletion deductions that inde-

pendent producers can use. Furthermore, most corporations can expense only 70 percent of their exploration and development costs, including intangible drilling costs, while noncorporate producers can expense all of them. Finally, because percentage depletion and expensed exploration and development costs are tax preferences under the alternative minimum tax, producers who pay the minimum tax must defer or even forgo these deductions, while producers who pay the regular income tax may take them currently.

There are several reasons to repeal expensing and percentage depletion. First, these provisions allocate capital to drilling and mining that firms could use more productively elsewhere in the economy. Second, they encourage the use of scarce domestic oil and gas resources, which may lead to a greater reliance on foreign energy producers in the future. Third, the provisions fail to provide all producers with the same incentive, which lessens their effectiveness in encouraging production.

Repealing the expensing of intangible drilling costs and other exploration and development costs would raise $6.1 billion in 1995 through 1999, assuming that firms could still expense the costs of dry holes, unproductive mines, and worthless mineral rights. Repealing percentage depletion would raise $4.9 billion over the same five-year period.

REV-27 ELIMINATE PRIVATE-PURPOSE, TAX-EXEMPT BONDS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Eliminate All Private-Purpose, Tax-Exempt Bonds	0.2	0.6	1.1	1.5	1.9	5.3
Raise the Cap and Extend Limits on Volume to New Issues of All Private-Purpose Bonds	a	0.2	0.3	0.5	0.6	1.6

SOURCE: Joint Committee on Taxation.

a. Less than $50 million.

The tax law permits state and local governments to issue bonds that are exempt from federal taxation. For the most part, the bond proceeds have financed public investments such as schools, highways, and water and sewer systems. Beginning in the 1960s, however, state and local governments began to issue a growing dollar volume of tax-exempt bonds to finance quasi-public facilities, such as ports and airports, and private-sector projects, such as housing and shopping centers. These bonds eventually became known as "private-purpose" bonds because the ultimate users of the tax-exempt-financed facilities were private nongovernmental entities.

Private-purpose, tax-exempt bonds include mortgage bonds for rental housing and single-family (in some cases two-family) homes; bonds for exempt facilities, such as airports, docks, wharves, mass commuting, and solid waste disposal; small-issue bonds for manufacturing facilities and agricultural land and property for first-time farmers; student loan bonds, which state authorities issue to increase the funds available for guaranteed student loans; and bonds for nonprofit institutions, such as hospitals and universities.

Although private-purpose bonds provide subsidies for activities that may merit federal support, tax-exempt financing is not the most efficient way to provide assistance. With a direct subsidy, the benefit would go entirely to the borrower; with tax-exempt financing, the borrower of funds shares the benefit with the investor in tax-exempt bonds. In addition, because tax-exempt financing is not a budget outlay, the Congress may not routinely review it as part of the annual budget process.

The Congress has placed restrictions on tax-exempt financing several times, beginning in 1968. During the 1980s, these restrictions included limiting the volume of new issues of tax-exempt bonds for some activities and eliminating or setting expiration dates on the use of tax-exempt bonds for other facilities. The Congress frequently postponed some of the expiration dates, however. In the Omnibus Budget Reconciliation Act of 1993, the Congress permanently extended the use of mortgage bonds for single-family (and some two-family) homes and of small issues for manufacturing facilities and agricultural land and property for first-time farmers.

The Tax Reform Act of 1986 included interest earned on newly issued private-purpose bonds in the base for the alternative minimum tax and placed a single state-by-state limit on the volume of new issues of exempt facility bonds, small issues, student loan bonds, and housing and redevelopment bonds. The state volume limits are the greater of $50 per resident or $150 million a year. Bonds for publicly owned airports, ports, and solid waste disposal

facilities and bonds for nonprofit 501(c)(3) organizations (primarily hospitals and educational institutions) are exempt from the limits on issues of new bonds. Large private universities and certain other nonprofit institutions may not issue tax-exempt bonds if they already have more than $150 million in tax-exempt debt outstanding.

If the Congress were to eliminate tax exemption for all new issues of private-purpose bonds, the revenue gain would be about $5.3 billion in 1995 through 1999. This amount assumes that at least some construction of airports and sewage and solid waste facilities would qualify for tax-exempt financing as governmental in nature. Eliminating the tax exemption would eventually raise the cost of the services provided by nonprofit hospitals and other facilities that currently qualify for tax-exempt financing, but the cost increase would be small and gradual.

Including all bonds for private nonprofit and quasi-public facilities in a single state volume limit, while raising the limits beginning in 1995 to, say, $75 per capita or $200 million a year, would increase revenues by $1.6 billion in 1995 through 1999. Those changes would curb the growth of all private-purpose bonds without sharply reducing their use. The curb would primarily affect bond issues for nonprofit hospitals, which are not included in the current cap. The proposal would also apply to bonds for airport facilities, such as departure gates, which are for the exclusive private use of airlines under long-term leases, but would continue to allow unlimited tax-exempt financing of public airport facilities, such as runways and control towers.

REV-28 CAPITALIZE THE COSTS OF PRODUCING TIMBER

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	0.8	1.2	1.2	1.2	1.3	5.7

SOURCE: Joint Committee on Taxation.

Businesses that incur costs to produce or purchase products that will be sold in future years generally cannot deduct these costs until the products are sold. Instead of deducting production and acquisition costs in the year they are incurred, businesses must capitalize such costs by adding them to the cost basis of inventory. When the product is sold from inventory, the business deducts the cost basis of the inventory from the sales price to determine the amount of taxable income. When businesses do not capitalize costs properly, business income is not measured correctly because the costs associated with producing goods and services are not matched with the sale of the goods and services.

The Tax Reform Act of 1986 (TRA-86) established a uniform set of rules for capitalizing production costs, but explicitly exempted the production of timber and certain ornamental trees. The rules require businesses to capitalize not only direct costs, such as the cost of production materials and the compensation paid to production workers, but also the allocable portion of most indirect costs that benefit production. These indirect costs include property taxes and insurance costs for the plant and equipment, and the salaries and benefits of production managers. Moreover, if a product takes longer than two years to produce or if it has a useful life of 20 years or more, the interest cost that is allocable to the production of the product must also be capitalized.

Because the production of timber and certain ornamental trees is currently exempt from the uniform capitalization rules, the producers of these products can deduct costs that otherwise would have to be capitalized. The deductible costs include the costs of labor and materials to remove unwanted trees and to control fire, disease, and insects; interest and insurance costs; property taxes; and administrative overhead. By allowing timber producers to deduct such production costs before the timber is harvested or sold, in effect, the tax code "subsidizes" timber producers by providing them with long-term, interest-free loans from the government. (Under certain circumstances, however, the subsidy to noncorporate producers of timber may be greatly curtailed by the tax code's limitation on losses from passive business activities.)

The subsidy from the interest-free loans distorts investment behavior in two ways: more private land is devoted to timber production, and trees are allowed to grow longer before they are cut. Without any spillover benefits from growing timber, these distortions lower the social return on investment in timber below that of alternative investments.

Whether or not timber production offers spillover benefits is unclear. Although standing timber provides some spillover benefits by deterring soil erosion and absorbing carbon dioxide (a gas linked to global warming), the cutting of timber can lead to soil erosion. In addition, the production of wood and paper products and the disposal of them add to pollution.

Capitalizing costs incurred after December 31, 1994, to produce timber and ornamental trees (in accordance with the uniform capitalization rules of TRA-86) would raise $5.7 billion in revenue from 1995 through 1999 by accelerating tax payments

from timber producers. In the long run, the capitalization of timber production costs will raise the price of domestic timber and lower the value of land used to grow timber. Moreover, lease payments to private landowners by timber growers are likely to decline, causing some land that historically has been devoted to growing timber to be used in other ways. In the short run, however, capitalizing timber production costs may lower the price of domestic timber because producers have an incentive to harvest timber earlier when currently deductible costs have to be capitalized.

REV-29 REPEAL THE ALCOHOL FUELS CREDIT AND PARTIAL EXCISE TAX EXEMPTION

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Addition to CBO Baseline	0.5	0.6	0.7	0.7	0.7	3.2

SOURCE: Joint Committee on Taxation.

Current law provides two tax preferences for producing alcohol fuels. The preferences are the alcohol fuels income tax credit (AFC) and the partial excise tax exemption from the motor fuels tax. One purpose of these tax preferences is to increase national security by reducing the demand for oil and thereby reducing U.S. dependence on foreign oil sources. Another purpose is to provide an additional market for the U.S. corn crop. Immediate repeal of the AFC and the partial excise tax exemption would raise $3.2 billion in revenues over 1995 through 1999.

The AFC is available to producers of alcohol from nonfossil fuel sources that is used in internal combustion engines. The alcohol may be blended with gasoline or diesel fuel. The AFC almost exclusively benefits ethanol, an alcohol fuel made from nonfossil fuel sources, primarily corn. The credit is nonrefundable and is subject to the limits applying to the general business credit. In addition, it must be included in gross income in the year it is received. Under current law, the credit expires on October 1, 1999.

Certain blends of gasoline or diesel and alcohol qualify for a partial excise tax exemption from motor fuels taxes. The exemption rate depends on the percentage of alcohol in the fuel and whether the alcohol was made from a fossil fuel or nonfossil fuel source. For example, gasohol, which is a blend of 10 percent ethanol and 90 percent gasoline, receives a 5.4 cents per gallon exemption from the 18.4 cents per gallon tax on gasoline. In addition, the AFC is reduced by the amount of the partial excise tax exemption that is claimed on the same fuel.

These tax preferences encourage energy producers to substitute ethanol for gasoline, resulting in an inefficient allocation of resources because ethanol production uses more resources than gasoline production. Moreover, the preferences do little to reduce petroleum imports. It is estimated that the preferences reduce imported petroleum by less than 1 percent. The need for the preferences has recently been reduced. The Clean Air Act Amendments of 1990 mandated the minimum oxygen content of gasoline in certain air pollution nonattainment areas, and ethanol is one of the two primary sources of oxygen in gasoline. (Methyl tertiary butyl ether, MTBE, is the other primary source of oxygen for gasoline. It does not receive a tax preference because it is made from natural gas.)

The net effect that repealing these tax preferences has on ethanol producers and on farm income and agricultural support payments depends on market conditions and on discretionary action taken by the Secretary of Agriculture. The income of ethanol producers would probably fall, with some ethanol plants taken out of production and much anticipated new capacity never completed. In response to the lower demand for corn from reduced ethanol production, the Secretary might increase corn set-asides to prop up corn prices, offsetting to some degree the decline in farm income. Federal outlays for the corn program would be affected depending on the Secretary's discretionary action and related changes in other farm programs.

Repeal would reduce the use of ethanol as a motor fuel oxygenate because it could not compete with MTBE. Initially, there might be a significant shortage of motor fuel oxygenate that would increase the price of MTBE. If a shortage developed, MTBE imports would increase temporarily until new capacity could be added to domestic production. During this transition, as much as 30 percent of MTBE used in gasoline could come from foreign sources.

REV-30 IMPOSE A VALUE-ADDED TAX

Addition to CBO Baseline	1995	1996	1997	1998	1999	Cumulative Five-Year Addition
	Annual Added Revenue (Billions of dollars)					
5 Percent Rate, with Comprehensive Base	0	96.3	154.9	172.4	184.3	607.9
5 Percent Rate, with Food, Housing, and Medical Care Excluded	0	50.6	81.4	90.6	96.9	319.5

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are based on an effective date of January 1, 1996. They are net of reduced income and payroll tax revenues, but do not reflect added administrative costs.

A value-added tax (VAT) is a form of general sales tax used in more than 50 countries, including 20 of the 25 members of the Organization for Economic Cooperation and Development. It is typically administered by taxing the total value of sales of all businesses, but allowing businesses to claim a credit for taxes paid on their purchases of raw materials, intermediate materials, and capital goods from other businesses. As a result, only sales to consumers end up being taxed.

A 5 percent VAT on a broad consumption base (as defined in Table 9) would increase net revenues by about $96 billion in fiscal year 1996 and $608 billion through 1999. Most VATs, however, do not tax such a broad base. The typical European VAT, for example, excludes food, housing, and medical care. It also partially excludes financial services because they are difficult to tax. A 5 percent VAT on a narrower base (as defined in Table 9) would net almost $51 billion in 1996 and about $320 billion through 1999. These revenue estimates assume that collections would not begin until January 1, 1996, because the Internal Revenue Service would need more than a year to set up a VAT.

A VAT might be preferable to an income tax increase because it would not discourage saving and investment by taxing their return. In addition, a broad-based VAT with a single rate would distort economic decisions less than would an equal revenue increase in selective consumption taxes. The VATs that have been enacted in other countries, however, include many tax preferences and multiple rates. Such a VAT would distort consumption choices more than a single-rate, broad-based VAT and could be more distorting than higher income tax rates.

A VAT makes the price consumers pay higher than the price sellers receive. Therefore, adopting one would cause an initial jump in the overall consumer price level because the government computes the consumer price index on a tax-inclusive basis. The increase in the price level, however, would not necessarily lead to further inflation, depending on how the Federal Reserve responded. Many experts believe that the Federal Reserve would adjust the money supply in a way that would maintain nominal income. Under this scenario, macroeconomic models generally predict little inflation beyond the initial price jump.

The VAT is a regressive tax in the sense that families with lower annual income pay a larger share of their income in tax. This effect occurs because the ratio of consumption to annual income is higher for low-income families than for high-income families. A VAT is less regressive over people's lifetimes than in a single year because income and consumption nearly match over a lifetime, even though income tends to fluctuate annually

more than consumption does. Many economists believe that lifetime measures of tax burdens are more meaningful than annual measures.

Table 9.
The Size of Two Possible Tax Bases for a Value-Added Tax, 1992

Items Included in Tax Base	Amount (Billions of dollars)
Broad Tax Base	
Total Personal Consumption in Gross Domestic Product	4,140
Net Purchases of Residental Structures	224
Subtotal	4,364
Exclusions from the Base[a]	
Rental value of housing	-600
Religious and welfare activities	-116
Subtotal	-716
Total	3,648
Narrower Tax Base	
Total Personal Consumption in Gross Domestic Product	4,140
Exclusions from the Base[a]	
Rental value of housing	-600
Religious and welfare activities	-116
All medical care (including insurance)	-705
Food consumed at home	-418
Food furnished to employees	-12
Food produced for farm consumption	b
Brokerage, banking, and life insurance services	-272
Local transit (excluding taxis)	-6
Clubs and fraternal organizations	-9
Tolls for roads and bridges	-2
Private education and research	-98
Subtotal	-2,238
Total	1,902

SOURCE: Congressional Budget Office based on national income and product accounts.

a. The excluded amount assumes that the specified consumption is taxed at a zero rate.

b. Reduction of less than $500 million.

A VAT could be made slightly less regressive by granting tax preferences for the goods and services low-income people generally consume. These preferences, however, would substantially increase the costs of enforcement and compliance, and they would reduce revenues. Another way to lessen the VAT's regressivity would be to allow additional exemptions or refundable credits for low-income people under the federal income tax. But exemptions for low-income people would also reduce the revenue gain and would cause many people to file tax returns who otherwise would have no need to file.

Like any new tax, a VAT would impose additional administrative costs on the federal government and additional compliance costs on businesses. If the United States adopted a VAT that was similar to those used in Europe, these costs could be quite substantial. CBO estimates that administering such a VAT would cost the government more than $[illegible] billion annually, and complying with it would cost businesses $6 billion to $10 billion annually. These costs would be lower if the VAT exempted more small businesses from collecting the tax and if it taxed as many goods and services as possible at the same rate.

A retail sales tax is another way to tax consumption. Because a sales tax is collected entirely at the retail level, however, the incentive to evade a sales tax would be much greater than the incentive to evade a VAT. Moreover, because the sales tax lacks an effective credit mechanism for the taxes that businesses pay on their purchases, it taxes some business purchases by mistake. Given the drawbacks of a retail sales tax, most countries with general consumption taxes have chosen a VAT over the sales tax.

Other ways to tax a broad consumption base are possible, even though no country has ever tried one. A tax on consumed income, for example, would tax income but with an exclusion for net saving. Under a consumed-income tax, taxpayers could deduct all contributions to qualified saving accounts but would pay tax on net withdrawals. Because individuals would pay tax on a measure of their total consumption, the tax could include a graduated rate schedule, like the rate schedule of the individual income tax. This schedule would make the consumed-income tax less regressive than a VAT.

REV-31 IMPOSE A BROAD BASED ENERGY TAX

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Impose a Tax on the Carbon Content of Fossil Fuels ($15 per ton)	13.2	19.6	20.3	21.1	21.9	96.1
Impose a Tax on the Heat Content of Fuels (33 cents per million Btus)	14.7	20.2	20.9	21.7	22.6	100.1
Impose an Ad Valorem Tax on Energy Consumption (5.3 percent of value)	14.7	20.1	20.8	21.[illegible]	22.3	99.5

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are based on an effective date of January 1, 1995, and are net of reduced income and payroll tax revenues. Increases in federal government expenditures for energy products under these options are not included. The estimates are based on CBO's baseline oil price forecast of $15.80 per barrel in 1995, rising to $18.50 per barrel in 1999.

Imposing new or increasing existing energy taxes could raise significant amounts of revenue and encourage conservation, thereby reducing pollution associated with energy use. But broad-based energy taxes would impose new costs on the economy, changing the mix and amount of energy use and temporarily reducing economic output. Broad-based energy taxes could also have adverse distributional effects because families with lower annual incomes spend a larger share of their income on energy than families with higher incomes. The distributional effects of energy taxes are not generally significantly different, however, from those of a general consumption tax, such as a value-added tax (see REV-30), which would not further environmental goals.

Broad-based energy taxes fall into three types: a carbon tax, a Btu tax, and an ad valorem tax. A tax on the carbon content of fossil fuels (coal, oil, and natural gas) would help to reduce global warming by reducing carbon emissions. The tax, however, would be relatively harsh on coal-producing regions and regions that generate electricity more from coal rather than other fuels. A tax on the heat content of fuels (measured in British thermal units, or Btus) that raised the same revenue would be more regionally neutral but would be less effective in reducing carbon emissions. An ad valorem tax on energy raising the same revenue would raise energy prices in a nondistortionary way, but would also be less effective in reducing carbon emissions than a carbon tax. None of these options would meaningfully reduce U.S. dependence on foreign oil.

A broad-based energy tax would be imposed on energy used by consumers, businesses and governments. The first option, a carbon tax, would be based on the carbon content of fossil fuels. This option is designed to raise about $20 billion each year, requiring a tax rate of $15 per ton of carbon (in 1995 dollars). The other two options, the Btu tax and the ad valorem energy tax, are designed to raise roughly the same amount of revenue. The base of a Btu tax would be the heat content of fuels with a tax rate of 33 cents per million Btus (in 1995 dollars). The carbon tax rates and Btu tax rates are indexed for inflation. In the case of an ad valorem tax, a tax of 5.3 percent would be applied to the retail value of energy consumed.

Broad-based energy taxes can have different effects across regions of the country because energy consumption patterns differ by region. For example, households in colder regions, such as the Northeast and Midwest, would face higher per capita increases in expenditures than households in more temperate regions. In addition, as is the case with selective excise taxes (see REV-33), all three of these options are regressive relative to family incomes because the share of income spent on energy declines as family income rises.

The costs of administering and collecting taxes increase as the number of taxpaying units increases. There could be tradeoffs, however, between the cost of administration and other objectives, such as price neutrality. All three of the options could be modified to change the tax collection point to either increase or decrease the number of taxpaying units.

The ultimate burden of the tax would not change, however, by shifting the tax collection point alone. The tax burden is after all determined by the conditions of supply and demand that exist in the markets for the taxed goods. The burden would depend on the ability of consumers and businesses to switch to lower-taxed fuels or conserve energy or do both.

All three options would cause a one-time increase in the U.S. general price level of about 0.4 percentage points and an offsetting one-time decline in the dollar's foreign exchange value. The prices of energy-intensive goods would increase more than the general price increase and the prices of goods that are not energy intensive would increase less. As a result, the prices of goods produced in the United States that are energy intensive--such as aluminum and chemicals--would rise when valued in foreign currency terms, making these U.S. products less competitive in world markets. Similarly, the prices of goods produced in the United States that are not energy intensive would fall when valued in foreign currency terms, making these U.S. products more competitive in world markets.

To alleviate the adverse effects on the domestic energy and energy-intensive industries, the United States might consider instituting border adjustments. The simplest form of border adjustment would be to impose the tax on imported energy and rebate the tax on exported energy. All three options make this adjustment. The adjustment eases the impact on the domestic energy industry, but not the impact on domestic producers of energy-intensive goods. Border adjustments on the energy content of all goods would also mitigate the adverse effects on energy-intensive industries, but they would be complicated and costly to administer. Therefore, they are not included in these options.

Impose a Tax on the Carbon Content of Fossil Fuels. A tax of $15 per ton of carbon content (in 1995 dollars) of coal, oil, and natural gas, if it were indexed for inflation, would raise about $100 billion over 1995 through 1999. The relative carbon content of the three fossil fuels would dictate the specific tax rate for each fuel. This tax rate, based on average carbon content, is equivalent to a tax of approximately $9.10 per ton of coal, $1.95 per barrel of oil, and about $0.25 per thousand cubic feet of natural gas (in 1995 dollars). In terms of current prices of fossil fuels, the tax equals about 35 percent of the minemouth price of coal, about 6 percent of the price of refined petroleum, and about 4 percent of the price of natural gas delivered to consumers. The percentage increase in the price of electricity, however, would be smaller than the percentage increase in the price of coal because coal, at current prices, accounts for only 25 percent of electric utility costs.

Imposing a carbon-based tax at the minemouth, wellhead, or dockside for imports could discourage the use of fossil fuels and also encourage switching from higher carbon-emitting fuels to lower ones, thereby reducing subsequent emissions of carbon dioxide (CO_2). The Congress could impose higher tax rates on fossil fuels than assumed in this option, for example either at levels that would discourage future increases in CO_2 emissions or at levels that would reduce emissions from current amounts by some target date.

Recent scientific evidence on the potential for global warming through an intensified greenhouse effect has prompted international concern about the emissions of greenhouse gases. Changes in temperature could result from increasing concentrations of certain trace gases that trap excess solar heat in the

atmosphere and thus affect the Earth's climate. The United States, along with some 150 nations, signed a climate treaty at the June 1992 "Earth Summit" conference in Brazil, agreeing to initiate steps aimed at controlling emissions of greenhouse gases. Last fall, the Administration announced an "Action Plan" for reducing greenhouse gases through voluntary action by government and businesses. A leading greenhouse gas is CO_2, which industries and households produce when they burn fossil fuels. A $15 per ton carbon tax (in 1995 dollars) would reduce CO_2 emissions by about 1 percent to 2 percent from projected levels by 1999.

U.S. action, however, would not significantly reduce global CO_2 concentrations if other countries did not make similar efforts. In addition, since scientists do not fully understand how emissions of greenhouse gases affect atmospheric concentrations, even reducing CO_2 emissions significantly may not prevent global warming. Moreover, a tax that significantly reduced emissions could impose economic costs that exceeded the benefits of this policy. Adjusting to lower energy use would be costly, especially in energy extracting and processing industries and in energy-intensive manufacturing sectors. Furthermore, other means of controlling greenhouse gases could be adopted. Another alternative to raising energy prices through an excise tax on carbon is to adapt to a warmer globe. This approach could be justified if the expected costs of adjusting to a warmer climate were less than the costs of adjusting to a tax or other methods of reducing greenhouse emissions.

This option would impose greater costs on colder regions of the country, like the Northeast and Midwest, and on regions that produce electricity primarily from coal. Coal-producing regions might also be hurt relatively more as utilities switched from coal to other methods of producing electricity.

Impose a Tax on the Energy Content of All Fuel Sources. A tax of 33 cents per million Btus (in 1995 dollars) imposed on all energy sources and indexed for inflation would also raise about $100 billion over 1995 through 1999. The relative heat content of coal, oil, and natural gas would dictate the specific tax rate for each fuel. This tax rate, based on average heat content, is equivalent to a tax of approximately $7.05 per ton of coal, $1.80 per barrel of oil, and about $0.35 per thousand cubic feet of natural gas (in 1995 dollars). Under this option, the change in relative prices between fossil fuels is similar to the change in relative prices under the carbon tax option because the carbon content of fuel is closely related to the heat content of fossil fuels. On average, the tax rates in this option are lower than those under the carbon tax option because the tax base is broader, including nuclear, hydropower, and other renewable resources. Nonetheless, the tax rate on natural gas is higher than under a carbon tax because the heat content is higher relative to the carbon content for natural gas than for coal and petroleum. Because the average price increases for fossil fuels would be smaller under a Btu tax than under a carbon tax, the CO_2 emissions reduction would not be quite as large as under the carbon tax option.

This tax would be easiest to administer if the Internal Revenue Service (IRS) collected it at the points where fossil fuels enter the economy--minemouth, wellhead, or dockside for imports--because it would minimize the number of taxpayers. The tax should be imposed on fuel used in the fuel production and distribution industries to capture all the energy consumed. If the tax is not imposed on alternative fuels--including hydroelectricity, nuclear, geothermal, and synthetic fuels--then the regional disparities of the tax would be magnified. For example, the Northwest generates more electricity from hydropower than other regions of the country.

The House of Representatives passed one version of a modified Btu tax last year. The Congress did not approve this option, however.

Impose an Ad Valorem Tax on All Energy. A tax of 5.3 percent levied at the retail level on all forms of energy would also raise about $100 billion over 1995 through 1999. An ad valorem tax applied at the retail level would leave the relative prices of different energy sources unchanged and therefore would not encourage consumers to switch from one form of energy to another. As a result, it would not decrease CO_2 emissions as much as a carbon tax for the same revenue increase. In addition, enforcement would be relatively costly with such a tax because the IRS would collect it from a large number of retailers. If the IRS collected the tax at an earlier stage of the distribution process, tax enforcement would be less costly, but the tax would then affect relative energy prices because different fuels have different markups at the retail level.

REV-32 INCREASE EXCISE TAXES ON TOBACCO AND ALCOHOLIC BEVERAGES

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Increase Cigarette Tax to 48 Cents per Pack	5.3	4.4	4.3	4.1	4.0	22.1
Increase Cigarette Tax to 99 Cents per Pack	13.3	10.5	10.2	9.9	9.6	53.5
Increase All Alcoholic Beverage Taxes to $16 per Proof Gallon	4.7	4.6	4.6	4.6	4.6	23.1
Index Cigarette and Alcohol Tax Rates for Inflation	0.3	0.6	1.0	1.3	1.6	4.8

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues.

Federal alcohol and tobacco taxes raised $13.5 billion in 1993, including $7.6 billion from taxes on distilled spirits, beer, and wines, and $5.9 billion from taxes on tobacco. The Omnibus Budget Reconciliation Act of 1990 increased the federal excise tax on tobacco and most alcoholic beverages.

Smoking and drinking can create costs to society that the prices of tobacco and alcoholic beverages do not reflect. Examples of these "external costs" include higher health insurance costs to cover the medical expenses linked to smoking and drinking, the effects of cigarette smoke on the health of nonsmokers, and the loss of lives and property in alcohol-related accidents.

To the extent that excise taxes raise the price and reduce consumption of tobacco and alcoholic beverages, tax increases can further reduce the total external costs that smoking and drinking produce. If those external costs primarily come from heavy or abusive consumption, however, then higher taxes on tobacco and alcoholic beverages might unduly penalize moderate and infrequent smokers and drinkers.

Increasing excise taxes to reduce consumption may be desirable regardless of the effect on external costs if consumers are either unaware of or underestimate the harm that their smoking and drinking does to them. Teenagers, in particular, may not be prepared to evaluate the long-term effects of smoking and drinking. Evidence suggests that teenage smoking and drinking declines in response to higher prices for tobacco and alcoholic beverages. A number of national medical organizations have supported a substantial increase in the existing federal excise tax on tobacco in the interests of reducing teenage smoking.

Taxes on tobacco and alcoholic beverages are regressive when compared with annual family income; that is, taxes are a greater percentage of income for low-income families than for middle-

and upper-income families. (See Congressional Budget Office, *Federal Taxation of Tobacco, Alcoholic Beverages, and Motor Fuels*, August 1990.)

Increase the Cigarette Tax. The current federal excise tax on cigarettes is 24 cents per pack. Raising it to 48 cents a pack on October 1, 1994, would increase net revenue by about $22.1 billion between 1995 and 1999. The President's Health Security Act proposes to raise the federal excise tax on cigarettes to 99 cents per pack, effective October 1, 1994. That change in isolation would increase net revenues by about $53.5 billion between 1995 and 1999.

Increase Taxes on Alcoholic Beverages. Current federal excise taxes on beer and wine remain much lower than the federal excise tax on distilled spirits in terms of the tax per ounce of ethyl alcohol. The current tax on distilled spirits of $13.50 per proof gallon results in a tax of about 21 cents per ounce of alcohol. The current tax on beer of $18.00 per barrel results in a tax of about 10 cents per ounce of alcohol (assuming an alcoholic content for beer of 4.5 percent), and the current tax on table wine of $1.07 per gallon results in a tax of about 8 cents per ounce of alcohol (assuming an average alcoholic content of 11 percent).

Increasing the federal excise tax to $16.00 per proof gallon for all alcoholic beverages effective October 1, 1994, would raise $23.1 billion between 1995 and 1999. A tax of $16.00 per proof gallon would result in a tax of about 25 cents per ounce of ethyl alcohol. It would raise the tax on a 750-milliliter bottle of distilled spirits from about $2.14 to $2.54, the tax on a six-pack of beer from about 33 cents to 81 cents, and the tax on a 750-milliliter bottle of table wine from about 21 cents to 70 cents.

Index Cigarette and Alcohol Tax Rates for Inflation. Indexing cigarette and alcoholic beverage tax rates annually beginning October 1, 1994, for inflation during the preceding year would raise $4.8 billion between 1995 and 1999. Indexing these taxes would prevent inflation from eroding real tax rates and would avoid the need for abrupt increases in the future.

An alternative to indexing would be to convert current unit taxes on quantities of these goods to ad valorem taxes, which equal a percentage of the manufacturer's price. This method would link tax revenues to price increases, although it would tie revenues to the price of taxed goods, not the general price level. A shortcoming of the ad valorem tax is that it might create incentives for manufacturers to lower sales prices artificially to company-controlled wholesalers in order to avoid part of the tax.

REV-33 INCREASE TAXES ON PETROLEUM AND MOTOR FUELS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Impose Tax on Domestic and Imported Oil ($5 per barrel)	16.5	22.0	22.2	22.6	22.9	106.2
Impose Oil Import Fee ($5 per barrel)	7.4	10.3	10.8	11.4	11.9	51.8
Increase Motor Fuel Taxes by 12 Cents per Gallon	8.8	11.8	11.5	11.3	11.2	54.6
Increase Motor Fuel Taxes by 10 Cents per Gallon Each Year for Five Years	7.4	17.1	26.1	34.5	42.2	127.3

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are based on an effective date of January 1, 1995, and are net of reduced income and payroll tax revenues. Increases in federal government expenditures for energy products under these options are not estimated. The revenue estimates are based on CBO's baseline oil price forecast of $15.80 per barrel in 1995, rising to $18.50 per barrel in 1999.

Increasing energy taxes could raise significant amounts of revenue, encourage conservation by making energy more expensive, reduce pollution, and decrease the country's dependence on foreign oil suppliers. The United States depends on foreign sources for nearly one-half of its oil and about one-fifth of its total energy. Recent experience illustrates that this dependence on foreign sources exposes the U.S. economy to potential interruptions in energy supplies and to volatile energy prices.

Imposing new or higher energy taxes would raise energy prices and reduce energy consumption, thus helping to promote conservation. To the extent that taxes on oil reduce the demand for imported oil, foreign suppliers would absorb part of the tax through lower world oil prices. To the extent that energy taxes reduce energy consumption, the taxes would also reduce carbon dioxide emissions and could, therefore, contribute to efforts to reduce global warming.

Energy taxes would have different effects on taxpayers in different parts of the country and with different incomes. Taxes that increase the relative price of fuel oil would have the greatest impact on consumers in the Northeast, and taxes that increase the relative price of gasoline would have the greatest impact on consumers in the West. In addition, taxes on gasoline and other energy products are a greater percentage of income for low-income families than for middle- and upper-income families.

Taxing energy is not the only way of reducing dependence on foreign oil supplies. Stockpiling oil is arguably a better way of coping with the risks of increased dependence on imports because it would not artificially reduce current energy use by house-

holds and businesses. This argument is based on the premise that, aside from the problem of interruptions in supply, world energy prices accurately reflect real resource costs and thus already provide an appropriate incentive to conserve energy.

Impose an Excise Tax on Domestic and Imported Oil. An excise tax of $5 per barrel on all crude oil and refined petroleum products--both domestically produced and imported--would raise revenues by about $106 billion from 1995 through 1999. It could increase the price of a gallon of gasoline or fuel oil by as much as 12 cents.

A tax on oil would increase the price that consumers must pay, giving them an incentive to use less oil either through conservation efforts or by switching to an alternative source of energy such as natural gas or coal. The tax would cause oil reserves to decline in value, and coal and gas reserves to increase in value. These shifts in value would discourage the exploration and production of oil and would encourage the production of coal and natural gas.

An oil tax, whether on all oil or only imported oil, would raise the costs for industries that use oil as the primary production input (for example, petrochemicals and paints). Consequently, domestic companies in these industries would find it more difficult to compete with foreign companies that would pay less for oil. To ameliorate this loss in competitiveness, it would be necessary to impose the same tax rate on the oil content of competing imports. Such a tax would be very cumbersome to design and administer.

Impose an Oil Import Fee. As an alternative to an excise tax on all oil, the Congress could impose the tax only on imported crude oil and refined petroleum products. An oil import fee of $5 per barrel would raise revenues by about $52 billion from 1995 through 1999.

An oil import fee would allow domestic suppliers to charge a higher price and still remain competitive with imports, providing an incentive to increase domestic crude oil production and a windfall to some domestic oil producers. Like the tax on all oil, the fee would also maintain incentives for conservation by increasing energy prices. These effects would reduce U.S. dependence on foreign oil in the short term, although in the long term they might increase dependence by depleting U.S. oil supplies faster. Domestic and foreign oil are relatively close substitutes and, therefore, the difference in the prices consumers would pay for them would be slight. But foreign producers would receive a lower net price than domestic producers because of the fee. A large portion of this difference between the net price that domestic and foreign producers would receive represents a transfer of income from domestic consumers to domestic producers. Consequently, the federal government would receive only about half of the increase in consumers' expenditures for oil under an import fee because the U.S. imports nearly half of the oil it consumes and demand is price insensitive in the short run.

Because an oil import fee would reduce U.S. demand for imported oil, important U.S. trading partners might object to it. Under the terms of the United States-Canada Free Trade Agreement, Canadian oil imports would be exempt from an import fee. However, a similar exemption does not apply to Mexican oil under the North American Free Trade Agreement. Because imports from Canada now account for almost 15 percent of U.S. oil imports, the Canadian exemption reduces the fee's revenue potential substantially. Legislation implementing a fee requires special rules to prevent other countries from avoiding the tax by shipping oil through Canada. An import fee might also violate the General Agreement on Tariffs and Trade (GATT), although disagreement exists on whether GATT exempts oil import fees that countries impose to protect national security.

Increase Motor Fuel Excise Taxes. Federal motor fuel taxes were increased by 4.3 cents per gallon in the Omnibus Budget Reconciliation Act of 1993. They are currently 18.4 cents per gallon of gasoline and 24.4 cents per gallon of diesel fuel. Revenue from 6.8 cents per gallon goes into the general fund until September 30, 1995, and revenue from 4.3 cents per gallon will go to the general fund beginning October 1, 1995. The remaining revenue goes into the Highway Trust Fund and several related trust funds.

State governments also impose gasoline and diesel taxes, ranging from 7.5 cents to 29 cents per gallon. Twenty-seven states have increased motor fuel tax rates since January 1991, and currently five states have announced increases going into effect in 1994. However, in comparison with motor fuel tax rates in other countries, many of which are well over $1 a gallon, U.S. tax rates are still among the lowest in the world.

Each additional penny of tax would generate roughly $1 billion in revenues per year. A 12 cent increase would raise motor fuel prices by about the same as a $5 per barrel oil tax. Although a 12 cent increase could increase the general price level, it would not permanently increase the rate of inflation.

The average national price of all grades of gasoline has dropped from a peak of about $1.40 per gallon in March 1981 to about $1.20 in the fall of 1993. This represents a 14 percent price reduction in nominal terms and 53 percent in real terms. Therefore, an additional tax of 12 cents or even 50 cents per gallon would not put the total cost of gasoline above what consumers have already experienced in real terms.

If the Congress used the additional tax revenues to finance additional highway spending, other discretionary spending would have to decrease by an equal amount, assuming that the Congress adhered to the discretionary spending caps. If so, the deficit would decrease by the additional tax revenues.

A tax increase would reduce consumption of gasoline and diesel fuel by encouraging people to drive less or purchase more fuel-efficient cars and trucks. In addition, the tax would offset, though imperfectly, the costs of pollution and road congestion that automobile use produces. A rate increase on motor fuel taxes would not adversely affect U.S. competitiveness because final consumers and the domestic transportation industry purchase most of the motor fuel.

Increasing tax rates on motor fuels would impose an added burden on the trucking industry and on people who commute long distances by car, who are not necessarily the highway users who impose the highest costs of pollution and congestion on others. Pollution and congestion costs are much higher in densely populated areas, primarily in the Northeast and coastal California, whereas per capita consumption of motor fuel is highest in rural areas. A 50 cent tax increase would produce significant adjustment costs for people and businesses who have based decisions about where they live and work and their choice of vehicle on low gasoline prices. Phasing in the tax increase, however, would reduce these costs by allowing businesses and consumers more time to adjust.

An additional 12 cent per gallon federal tax on motor fuels would raise about $55 billion from 1995 through 1999. Alternatively, five successive annual 10 cent increases would raise about $127 billion over that same period.

REV-34 IMPOSE EXCISE TAXES ON WATER POLLUTANTS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1995	1996	1997	1998	1999	
Tax on Biological Oxygen Demand	1.3	1.9	1.9	1.9	1.9	8.9
Tax on Toxic Water Pollutants	2.5	3.6	3.6	3.6	3.6	16.9

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll taxes.

Major facilities that discharge pollutants directly into water or indirectly into sewer systems are currently subject to regulations that specify pollution abatement technology or impose concentration limits on their discharges. Taxes on water pollutants discharged by these facilities could provide a significant source of revenue and could encourage further reductions in pollution below the level that current regulations require. Generally, firms subject to water pollution standards do not pay taxes or fees on effluents (discharges) that regulations still allow. There are two major types of water pollutants: biological oxygen demand (BOD) and toxics. One option is to impose a tax on BOD discharges. BOD is a common measure of water quality because excessive levels of BOD make it difficult to sustain aquatic life. (One BOD equals one milligram of oxygen consumed per liter of effluent.) A second option would impose a tax of varying rates on certain toxic discharges.

Taxes can reduce pollution in a cost-effective manner because they encourage firms with the lowest abatement costs to reduce pollution, while allowing firms with high abatement costs to continue polluting and pay the tax. Reductions in discharges caused by the tax would increase welfare if the additional abatement costs were less than or equal to the social benefits from reduced pollution levels. However, accurate estimates of additional social benefits from reducing pollution levels do not exist in many cases. In addition, imposing a tax on one class of pollutants might reduce other pollutants because some wastewater treatment processes reduce several pollutants simultaneously. In addition, constitutional issues concerning federal taxation of local governments may arise, requiring direct taxation of primary sources that discharge to publicly owned treatment works (POTWs) rather than taxing the POTWs themselves.

Tax on Biological Oxygen Demand. BOD measures the effect of pollutants that encourage algae growth, which in turn depletes oxygen necessary to sustain much aquatic life. Most of the high-volume dischargers (sometimes referred to as point sources) are POTWs, paper and pulp mills, food processors, metal producers, and chemical plants. Total discharges by point sources are about 4.8 million liters per day. About 4.4 million liters of this amount are discharged by publicly owned treatment works.

The cost of controlling BOD discharges at POTWs and many industries subject to the Clean Water Act regulations averages about 5 cents to 7.5 cents per BOD removed. A charge on BOD discharges could encourage manufacturing facilities and POTWs that face lower abatement costs to reduce pollution. Assuming effluents record an average concentration of 22 BOD, a tax of about 6.4 cents per BOD discharged would raise $8.9 billion between 1995 and 1999. The revenue estimates cited here, however, assume that no additional abatement from imposition of the tax occurs

and that firms cannot exceed allowable standards. If additional abatement were to occur, revenue collections would be lower.

Costs of administering a BOD water pollution excise tax would be small because allowable levels of BOD discharges are specified in the permits issued to every source of water pollution by state or federal governments. Levying a tax on effluents from POTWs, as well as from large industrial dischargers, would ensure that the tax base would include all of the largest dischargers of BOD. If a tax could not be levied for constitutional reasons directly on POTW discharges, the POTWs themselves could collect the tax directly from polluters that discharge into sewer systems.

Tax on Toxic Water Pollutants. The manufacturing sector in the United States discharged more than 240 million pounds of toxics into water directly in 1991 and more than 400 million pounds of toxics into water indirectly through sewers. Toxic pollutants generally include organic chemicals (such as solvents and dioxins), metals (such as mercury and lead), and pesticides. These toxics may pose a threat to the aquatic environment and to human health.

The amount of environmental harm that toxic water pollutants cause depends on their toxicity. The Environmental Protection Agency (EPA) has devised a weighting method to indicate the toxicity of various pollutants. Use of this weighting system makes it possible to measure the quantities of different types of toxics by their "toxic pound equivalents" (which the EPA defines as the pounds of the pollutant multiplied by its toxic weight).

This option adopts tax rates developed by the Congressional Research Service (CRS) in a study on manufacturing firms' discharges in 1987 and applies these rates to 1991 discharges. The CRS defined five different categories of pollutants based on their toxicities. The tax rates varied from 65 cents per pound for the least toxic category of pollutants to $63.40 per pound for the most toxic category. These rates correspond to a charge of $32.35 per toxic pound equivalent. The variable tax rates provide firms with a greater incentive to reduce their most toxic discharges.

According to the EPA, the cost of controlling another toxic pound equivalent varies among industries, ranging from $1.50 to $606.00 per toxic pound equivalent (in 1991 dollars). This tax, therefore, could encourage industries and firms with low abatement costs to reduce their toxic discharges. Assuming that discharges of toxics remain the same, the tax would raise $16.9 billion from 1995 through 1999. Revenues could be lower, however, if the amount of toxic pollutants the firms discharge decreases as a result of the tax.

The Internal Revenue Service (IRS) could use information that the EPA's Toxic Release Inventory (TRI) provides on toxic discharges by manufacturing firms to assess tax payments or the EPA could collect the tax on behalf of the IRS. An important consideration, however, is that the accuracy of TRI data is questionable. The TRI contains self-reported data and many facilities that meet the reporting requirements fail to file reports or file inaccurate reports. In order to improve the accuracy of the TRI data base and enhance enforcement, it would be important to have frequent auditing.

REV-35 IMPOSE EXCISE TAXES ON AIR POLLUTANTS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
			Stationary Sources			
Impose a Tax of $432 per Ton on SO_x	4.3	6.4	6.4	6.4	6.4	29.9
Impose a Tax of $1,170 per Ton on NO_x	7.5	11.2	11.2	11.2	11.2	52.3
Impose a Tax of $3,610 per Ton on Particulate Matter (PM-10)	7.0	10.5	10.5	10.5	10.5	49.0
Impose a Tax of $5,000 per Ton on VOCs	36.3	54.2	54.2	54.2	54.2	253.1
			Mobile Sources			
Impose a One-Time Emission Tax (Averaging $250 per Vehicle) on New Automobiles and Light Trucks	1.8	2.8	2.9	2.9	2.9	13.3

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payr l axes.

The pollutants SO_x and NO_x are considered primarily responsible for acid rain, which the Environmental Protection Agency (EPA) believes degrades surface waters, damages forests and crops, and potentially increases the incidence of respiratory ailments. Large industrial sources, notably coal-fired electric utilities, emit significant quantities of these pollutants. Industrial production and the use of automobiles and trucks emit NO_x and volatile organic compounds (VOCs), which combine with sunlight and other compounds to produce ozone pollution. Electric utilities and motor vehicles emit particulate matter (PM-10) when they burn fossil fuels. Particulate matter can carry heavy metals and cancer-causing organic compounds into the lungs, thus increasing the incidence and severity of respiratory diseases. Carbon monoxide (CO) is produced primarily from the use of motor vehicles and residential woodburning, and it can also pose direct health hazards. In 1991, about 85 million people lived in areas that did not meet the EPA's National Ambient Air Quality Standards, which define acceptable levels of CO, NO_2, PM-10, SO_2, lead, and ozone.

With some minor exceptions, firms subject to air pollution standards must incur the costs needed to reduce emissions to comply with regulations. Most firms do not, however, pay taxes or fees on emissions that regulations still allow, although major point sources do pay approximately $400 million annually in user fees to cover program costs.

The marginal cost of pollution control for stationary sources varies, given the numerous industrial and other sources. The four options that tax pollution from stationary sources would base the tax rates on the average firm's estimated current cost of

reducing pollution at the margin. Some firms with low abatement costs may reduce pollution below allowable standards in response to the taxes. The option that taxes emissions from mobile sources (vehicles) could also reduce pollution levels. (See REV-31 and REV-33 for other taxes that might reduce emissions of air pollutants.) Reductions in emissions caused by the taxes would increase welfare if additional abatement costs were less than or equal to the social benefits from reduced pollution levels. However, accurate estimates of additional social benefits from reducing pollution levels do not exist in many cases.

The revenue estimates cited here, however, assume that no additional abatement from imposition of the taxes occurs and that firms cannot exceed allowable standards. If additional abatement were to occur, revenue collections would be lower.

Tax Emissions of SO_x and NO_x from Stationary Sources. Imposing taxes of $432 per ton of SO_x emissions and $1,170 per ton of NO_x emissions from all stationary sources would raise roughly $30 billion for SO_x and $52 billion for NO_x from 1995 through 1999. Basing the tax on the terms granted in air pollution permits would minimize costs of administration. The Internal Revenue Service (IRS) could collect the tax itself or the state and local government agencies that issue pollution permits could collect the tax on the behalf of the IRS. The present monitoring and reporting system for stationary sources that the EPA and state regulators operate could be used to enforce the tax. If polluters' actual emission levels were lower than permitted levels, polluters could apply for revised permits based on those actual levels. If the tax were based on permitted emissions levels, it would be equivalent to the government selling pollution permits at their fair market price.

The proposed tax on SO_x could reduce pollution below the mandated amounts contained in the Clean Air Act Amendments of 1990 (CAAA). Some electric utilities and manufacturing plants might switch to lower-sulfur coals because this would be less costly than paying the tax, and others might choose to operate their most heavily emitting plants less frequently or to install new SO_x control devices. The tax on NO_x could also reduce emissions below mandated levels contained in the CAAA if some firms adopt currently available abatement techniques whose capitalized costs per unit of reduced emissions are lower than the tax rate.

Tax Emissions of PM-10 from Stationary Sources. A tax of $3,610 per ton of particulate matter would raise $49 billion from 1995 through 1999, based on levels of emissions that the EPA projects under current regulations. Some electric utilities and manufacturing plants might install improved electrostatic precipitators, wet scrubbers, or other equipment that reduces PM-10 emissions to lower their tax burdens. This tax could be administered in the same manner as the taxes on SO_x and NO_x.

Tax Emissions of VOCs from Stationary Sources. Stationary sources of volatile organic compounds range from huge industrial facilities such as chemical plants, petroleum refineries, and coke ovens to small sources such as bakeries and dry cleaners. Their vast number and diversity make it difficult to estimate emissions and costs of abatement. A tax of $5,000 per ton on all stationary-source VOC emissions might promote some abatement and would generate about $253 billion in revenues from 1995 through 1999.

The advantage of a broad-based tax on VOCs is that it captures small sources, which the EPA estimates are responsible for approximately 80 percent of all emissions from stationary sources. Because stationary sources emitting less than 2.5 tons of VOCs per year are not currently subject to federal regulation, a broad-based VOC tax would be administratively more difficult to carry out than a tax on large sources alone. Assessing the tax on small sources on technology-based estimates of emissions rather than on measured emissions would reduce administrative costs, but make the incentives less precise. Alternatively, imposing the tax only on large stationary sources would raise only $10.8 billion annually.

Tax Emissions of NO_x, VOCs, and CO from Mobile Sources. A one-time tax imposed on new automobiles and light trucks could be based on grams of NO_x, VOCs, and CO emitted per mile as estimated under the EPA emission certification tests

required on every new vehicle. The tax could be administered like the "gas guzzler" excise tax. The EPA would determine the tail-pipe emissions for each new model light-duty vehicle and the tax would be based on these emissions rates. The auto dealer would collect the tax on behalf of the IRS from the vehicle purchaser.

Such a tax averaging $250 per vehicle could raise $13.3 billion in revenues from 1995 through 1999. The revenue estimates presented here are based on projected new car sales and assume that new cars meet, on average, current tail-pipe standards. Revenues would be lower than projected if the tax induced consumers to purchase more fuel-efficient vehicles. Also, if new cars become cleaner over time, revenues would be lower than projected. Vehicles made in earlier years have been excluded from the estimate because of the administrative problems of collecting a tax on older vehicles. A disadvantage of excluding them, however, is that earlier-year vehicles represent more than 90 percent of the light-duty vehicles in use and an even greater share of emissions. In addition, the tax would encourage people to delay purchases of new vehicles by raising their price.

REV-36 TAX ADDITIONAL OZONE-DEPLETING CHEMICALS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Addition
Impose ODC Tax on Methyl Bromide at Current Rates	0.1	0.2	0.2	0.2	0.2	0.9
Impose ODC Tax on HCFCs at Current Rates	0.1	0.1	0.1	0.1	0.2	0.6

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues.

In 1989, the Congress imposed an excise tax on chlorofluorocarbons (CFCs) and halons, chemicals with high potential to deplete ozone. The Congress added carbon tetrachloride and methyl chloroform to the list of chemicals subject to tax in 1990. Furthermore, the Congress increased the tax rates on ozone-depleting chemicals (ODCs) in the Energy Policy Act of 1992. Current law imposes a separate tax rate on each ODC. This rate is a product of the base tax rate and the ODC's ozone-depleting factor --a measure of the chemical's potential damage to the ozone layer. The base tax rate is $4.35 per pound in 1994, increasing to $7.15 per pound in 1999.

U.S. Environmental Protection Agency (EPA) regulations phase out most ODCs by 1996. The current tax could accelerate the phaseout.

The current tax excludes methyl bromide and hydrochlorofluorocarbons (HCFCs), chemicals that also damage the ozone layer. These chemicals are exempt for several reasons. Scientists only recently identified methyl bromide as a significant contributor to ozone depletion, while they still consider HCFCs to be much less harmful than CFCs. HCFCs are also valuable near-term substitutes for CFCs, serving as a bridge for industrial users. Recent scientific concerns, however, are that HCFCs may be more harmful than originally thought. At the end of 1992, 24 leading industrial countries recognized scientists' concerns about these ODCs by adding them to the Montreal Protocol, a 1987 accord that set international production limits and phaseouts on most of the known harmful ODCs.

Broadening the tax base to include methyl bromide and HCFCs could raise $1.5 billion from 1995 through 1999 and further spare the ozone layer. The new taxes would raise prices of the chemicals and some related retail prices, which could expedite the development of substitutes, alternative processes, and recycling programs.

Agricultural industries use methyl bromide as a pesticide and multipurpose fumigant. Its most prominent agricultural use is as a soil (fungicide) fumigant. Recent scientific evidence substantiates that methyl bromide is more harmful than many of the chemicals that current law taxes. EPA regulations phase out the production and importation of methyl bromide by the year 2001. Taxing it at current-law rates could raise $0.9 billion from 1995 through 1999.

As industries phase out CFCs, they will produce more HCFCs. EPA regulations, however, substantially reduce the production of HCFCs between the years 2003 to 2020 and completely phase out remaining production by 2030. Taxing HCFCs

could expedite this phaseout. Because HCFCs have a smaller ozone-depleting factor than CFCs, their applicable tax rates would be lower and would not affect their prices as significantly. Taxing HCFCs at current-law rates could raise $0.6 billion from 1995 through 1999.

Appendixes

Appendix A

Estimated Savings in the Department of Defense Budget for Selected National Defense Options

Table A-1 provides additional cost estimates for national defense options that affect military or civilian pay. Estimated savings in the federal budget for these options would be less because certain payments by the Department of Defense result in intragovernmental transfers that are offset within the total federal budget. The most significant of these payments are the accrual payments for military retirement and the government's contributions for civilian retirement systems.

Table A-1.
Estimated Savings in the DoD Budget for Selected Options in Budget Function 050

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
DEF-01 REDUCE NUCLEAR DELIVERY SYSTEMS WITHIN OVERALL LIMITS OF START II						
Savings from CBO Baseline						
Budget Authority	400	770	940	1,120	1,260	4,490
Outlays	300	640	830	1,020	1,170	3,960
Savings from CBO Estimate of Administration's Plan						
Budget Authority	130	350	560	780	920	2,740
Outlays	90	280	470	670	830	2,340
DEF-06 REDUCE THE NUMBER OF AIRCRAFT CARRIERS AND AIR WINGS TO 10						
Savings from CBO Baseline						
Budget Authority	3,950	700	1,150	1,640	1,690	9,130
Outlays	270	790	1,570	2,030	2,170	6,830
Savings from CBO Estimate of Administration's Plan						
Budget Authority	2,790	700	940	1,190	1,220	6,840
Outlays	260	720	1,210	1,460	1,550	5,200

(Continued)

Table A-1.
Continued

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
DEF-08 ELIMINATE FRIGATES FROM THE NAVAL FORCE						
Savings from CBO Baseline						
Budget Authority	120	370	640	920	1,230	3,280
Outlays	90	300	540	810	1,100	2,840
Savings from CBO Estimate of Administration's Plan						
Budget Authority	80	260	450	650	840	2,280
Outlays	60	210	380	570	760	1,980
DEF-10 REDUCE AIR FORCE TACTICAL FORCES						
Savings from CBO Baseline						
Budget Authority	180	990	1,650	1,700	1,760	6,280
Outlays	140	770	1,390	1,570	1,680	5,550
Savings from CBO Estimate of Administration's Plan						
Budget Authority	130	730	1,220	1,260	1,300	4,640
Outlays	100	560	1,020	1,160	1,240	4,080
DEF-14 REDUCE THE NUMBER OF ARMY LIGHT DIVISIONS						
Savings from CBO Baseline						
Budget Authority	420	1,410	3,090	4,870	6,000	15,790
Outlays	360	1,250	2,790	4,490	5,650	14,540
Savings from CBO Estimate of Administration's Plan						
Budget Authority	520	1,810	3,170	4,220	4,740	14,460
Outlays	440	1,590	2,880	3,910	4,500	13,320

(Continued)

Table A-1.
Continued

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1995	1996	1997	1998	1999	
DEF-18 RETIRE EXCESS KC-135 TANKERS						
Savings from CBO Baseline and CBO Estimate of Administration's Plan						
Budget Authority	40	120	210	300	400	1,070
Outlays	30	100	190	280	370	970
DEF-21 USE EARLY RETIREMENT TO REDUCE THE NUMBER OF MILITARY PERSONNEL						
Savings from CBO Baseline and CBO Estimate of Administration's Plan						
Budget Authority	-400	2,520	2,020	1,490	930	6,560
Outlays	-380	2,380	2,030	1,510	960	6,500
DEF-22 RESTRUCTURE OFFICER ACCESSION PROGRAMS						
Savings from CBO Baseline						
Budget Authority	130	210	300	390	390	1,420
Outlays	110	200	290	390	400	1,390
Savings from CBO Estimate of Administration's Plan						
Budget Authority	140	220	310	400	400	1,470
Outlays	120	210	310	400	410	1,450
DEF-23 REDUCE THE SIZE OF THE ARMY NATIONAL GUARD AND RESERVE						
Savings from CBO Baseline						
Budget Authority	220	690	1,190	1,720	2,280	6,100
Outlays	200	640	1,120	1,640	2,190	5,790
Savings from CBO Estimate of Administration's Plan						
Budget Authority	50	180	400	700	1,030	2,360
Outlays	50	170	390	690	1,020	2,320

(Continued)

Table A-1.
Continued

	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
DEF-24 RESTRUCTURE RESERVE COMPENSATION						
Savings from CBO Baseline						
Budget Authority	470	490	500	520	530	2,510
Outlays	450	490	500	520	530	2,490
Savings from CBO Estimate of Administration's Plan						
Budget Authority	450	430	430	430	430	2,170
Outlays	430	430	430	430	430	2,150
DEF-26 REDUCE DRILLS FOR NONCOMBAT RESERVE UNITS						
Savings from CBO Baseline						
Budget Authority	150	160	160	170	170	810
Outlays	140	160	160	160	170	790
Savings from CBO Estimate of Administration's Plan						
Budget Authority	150	140	140	140	150	720
Outlays	140	140	140	140	140	700
DEF-27 REDUCE GOVERNMENT SPENDING FOR MILITARY HEALTH CARE TO ACCOMPANY CAPITATION						
Savings from CBO Baseline						
Budget Authority	190	390	620	870	1,140	3,210
Outlays	140	330	550	780	1,050	2,850
Savings from CBO Estimate of Administration's Plan						
Budget Authority	180	370	580	820	1,080	3,030
Outlays	130	310	510	740	990	2,680

(Continued)

Table A-1.
Continued

	Annual Savings (Millions of dollars) 1995	1996	1997	1998	1999	Cumulative Five-Year Savings
DEF-29 CLOSE THE UNIFORMED SERVICES UNIVERSITY OF THE HEALTH SCIENCES						
Savings from CBO Baseline						
Budget Authority	20	30	50	80	80	260
Outlays	20	20	40	70	70	220
Savings from CBO Estimate of Administration's Plan						
Budget Authority	0	0	0	0	0	0
Outlays	0	0	0	0	0	0
DEF-32 REVAMP MILITARY FAMILY HOUSING						
Savings from CBO Baseline and CBO Estimate of Administration's Plan						
Budget Authority	750	780	800	740	630	3,700
Outlays	90	370	580	770	550	2,360
DEF-37 REDUCE AND RESHAPE DOD'S CIVILIAN WORK FORCE						
Savings from CBO Baseline						
Budget Authority	1,220	3,620	6,030	8,640	11,470	30,980
Outlays	920	2,940	5,250	7,770	10,510	27,390
Savings from CBO Estimate of Administration's Plan						
Budget Authority	390	1,150	2,030	3,250	4,750	11,570
Outlays	290	940	1,750	2,870	4,260	10,110

NOTE: For all national defense options not appearing in this table, savings in defense budget function 050 equal total federal savings.

Appendix B

Spending Options by Budget Function

050 National Defense

150 International Affairs

250 General Science, Space, and Technology

270 Energy

Glossary

This glossary defines economic and budgetary terms as they relate to this report. Some entries sacrifice precision for brevity and clarity to the lay reader. Where appropriate, sources of data for economic variables are indicated as follows:

BLS denotes the Bureau of Labor Statistics in the Department of Labor;

CBO denotes the Congressional Budget Office; and

NBER denotes the National Bureau of Economic Research.

appropriation act: A statute under the jurisdiction of the House and Senate Committees on Appropriations that provides budget authority. Enactment generally follows adoption of authorizing legislation unless the authorization itself provides the budget authority. Currently, 13 regular appropriation acts are enacted each year. When necessary, the Congress may enact supplemental or continuing appropriations.

authorization: A substantive law that sets up or continues a federal program or agency. Authorizing legislation is normally a prerequisite for appropriations. For some programs, the authorizing legislation itself provides the authority to incur obligations and make payments.

Balanced Budget and Emergency Deficit Control Act of 1985: Also known as Gramm-Rudman-Hollings or the Balanced Budget Act, the act sets forth specific deficit targets and a sequestration procedure to reduce spending if the targets are exceeded. The Budget Enforcement Act of 1990 established new budget procedures through fiscal year 1995 as well as revised targets, which exclude the Social Security trust funds. It gave the President the option to adjust the deficit targets for revised economic and technical assumptions when submitting the budget for fiscal years 1994 and 1995, an option he exercised. The Omnibus Budget Reconciliation Act of 1993 further extended various provisions of the Balanced Budget Act, without including fixed deficit targets beyond fiscal year 1995.

baseline: A benchmark for measuring the budgetary effects of proposed changes in federal revenues or spending, with the assumption that current budgetary policies are continued without change. As specified in the Budget Enforcement Act of 1990 (BEA), the baseline for revenues and entitlement spending generally assumes that laws now on the statute books will continue. The discretionary spending projections are based on the discretionary spending caps set by the BEA in 1995 through 1998 and are adjusted for inflation in 1996 through 1999.

budget authority: Legal authority to incur financial obligations that will result in spending of federal government funds. Budget authority may be provided in an authorization or an appropriation act. Offsetting collections, including offsetting receipts, constitute negative budget authority.

budget deficit: Amount by which budget outlays exceed budget revenues during a given period.

Budget Enforcement Act of 1990 (BEA): Title XIII of the Omnibus Budget Reconciliation Act of 1990. This act amended both the Congressional Budget Act of 1974 and the Balanced Budget and Emergency Deficit Control Act of 1985. The BEA provides for new budget targets, sequestration procedures, pay-as-you-go procedures, credit reform, and various other changes. The discretionary spending caps and the pay-as-you-go process were extended through 1998 by the Omnibus Budget Reconciliation Act of 1993.

budget function: One of 20 areas into which federal spending and credit activity are divided. National needs are grouped into 17 broad budget functions, including national defense, international affairs, energy, agriculture, health, income security, and general government. Three functions--net interest, allowances, and undistributed offsetting receipts--do not address national needs but are included to complete the budget.

budget resolution: A resolution, passed by both Houses of Congress, that sets forth a Congressional budget plan for the next five years. The plan must be carried out through subsequent legislation, including appropriations and changes in tax and entitlement laws. The resolution sets guidelines for Congressional action, but it is not signed by the President and does not become law. The Congressional Budget Act of 1974 established a number of mechanisms that are designed to hold spending and revenues to the targets established in the budget resolution.

budgetary resources: All sources of budget authority that are subject to sequestration. Budgetary resources include new budget authority, unobligated balances, direct spending authority, and obligation limitations. See **sequestration**.

compensation: All income due to employees for their work during a given period. Compensation includes wages and salaries as well as fringe benefits and employers' share of social insurance taxes. (Bureau of Economic Analysis)

constant dollar: Measured in terms of prices of a base period--currently 1987 for most purposes--to remove the effect of inflation. Compare with **current dollar**.

credit reform: A revised system of budgeting for federal credit activities that focuses on the cost of subsidies conveyed in federal credit assistance. This process was authorized by the Federal Credit Reform Act of 1990, which was part of the Budget Enforcement Act of 1990.

credit subsidies: The estimated long-term costs to the federal government of direct loans or loan guarantees calculated on the basis of net present value, excluding administrative costs and any incidental effects on governmental receipts or outlays. For direct loans, the subsidy cost is the net present value of loan disbursements less repayments of interest and principal, adjusted for estimated defaults, prepayments, fees, penalties, and other recoveries. For loan guarantees, the subsidy cost is the net present value of the estimated payments by the government to cover defaults and delinquencies, interest subsidies, or other payments, offset by any payments to the government, including origination and other fees, penalties, and recoveries. See **present value**.

current dollar: Measured in the dollar value--reflecting then-prevailing prices--of the period under consideration. Compare with **constant dollar**.

debt held by the public: Debt issued by the federal government and held by nonfederal investors (including the Federal Reserve System).

debt service: Payment of scheduled interest obligations on outstanding debt.

defense spending: See **discretionary spending**

deposit insurance: The guarantee by a federal agency that an individual depositor at a participating depository institution will receive the full amount of the deposit (up to $100,000) if the institution becomes insolvent.

direct spending: The Budget Enforcement Act of 1990 defines this term as (a) budget authority provided by an authorization, (b) entitlement authority (including mandatory spending contained in appropriation acts), and (c) the Food Stamp program. A synonym is **mandatory spending**. Compare with **discretionary spending**.

discretionary spending: Spending for programs whose funding levels are determined through the appropriation process. The [illegible] has the [illegible] each year to determine how many dollars will be devoted to continu[illegible] [illegible] and funding new ones. The Budget Enforcement Act of 1990 divided discretionary spending [illegible] defense, international, and domestic. Compare with **direct spending**.

[illegible] consists primarily of the military activities of the Department of Defense, [illegible] military construction appropriation bills. It also includes the defense-related [illegible] the Department of Energy's nuclear weapons programs.

[illegible] encompasses spending for foreign economic and military aid, the [illegible] the Department of State and the U.S. Information Agency, and international financial programs, such [illegible] Export-Import Bank of the United States.

[illegible] includes most government activities in science and space, transportation, [illegible] environmental protection, and law enforcement, among other spending programs. Funding for these programs is provided in 10 of the annual appropriation bills.

discretionary spending caps: Annual ceilings on budget authority and outlays for discretionary programs as defined by the Budget Enforcement Act of 1990 and the Omnibus Budget Reconciliation Act of 1993. For fiscal years 1991 through 1993, the caps were divided among the three categories of discretionary spending--defense, international, and domestic. For fiscal years 1994 through 1998, there is one cap for all discretionary spending. Discretionary spending caps are enforced through Congressional rules and sequestration procedures.

domestic discretionary spending: See **discretionary spending**.

entitlements: Programs that make payments to any person, business, or unit of government that seeks the payments and meets the criteria set in law. The Congress controls these programs indirectly by defining eligibility and setting the benefit or payment rules. Although the level of spending for these programs is controlled by the authorizing legislation, funding may be provided either in an authorization or an appropriation act. The best-known entitlements are the major benefit programs, such as Social Security and Medicare; other entitlements include farm price supports and interest on the federal debt. See **direct spending.**

excise tax: A tax levied on the purchase of a specific type of good or service, such as tobacco products or telephone services.

fiscal policy: The government's choice of tax and spending programs, which influences the amount and maturity of government debt as well as the level, composition, and distribution of output and income. An "easy" fiscal policy stimulates the short-term growth of output and income, whereas a "tight" fiscal policy restrains their growth. Movements in the standardized-employment deficit constitute one overall indicator of the tightness or [illegible] federal fiscal policy; an increase relative to potential gross domestic product suggests fiscal ease, whereas a decrease suggests fiscal restriction. The President and the Congress jointly determine federal fiscal policy.

fiscal year: A yearly accounting period. The federal government's fiscal year begins October 1 and ends September 30. Fiscal years are designated by the calendar years in which they end--for example, fiscal year 1993 began October 1, 1992, and ended September 30, 1993.

GDP: See **gross domestic product**.

GNP: See **gross national product**.

grants: Transfer payments from the federal government to state and local governments or other recipients to help fund projects or activities that do not involve substantial federal participation.

grants-in-aid: Grants from the federal government to state and local governments to help provide for programs of assistance or service to the public.

gross domestic product (GDP): The total market value of all goods and services produced domestically during a given period. The components of GDP are consumption, gross domestic investment, government purchases of goods and services, and net exports. (Bureau of Economic Analysis)

gross national product (GNP): The total market value of all goods and services produced in a given period by labor and property supplied by residents of a country, regardless of where the labor and property are located. GNP differs from GDP primarily by including the excess of capital income that residents earn from investments abroad less capital income that nonresidents earn from domestic investment.

inflation: Growth in a measure of the general price level, usually expressed as an annual rate of change.

infrastructure: Government-owned capital goods that provide services to the public, usually with benefits to the community at large as well as to the direct user. Examples include schools, roads, bridges, dams, harbors, and public buildings.

investment: *Physical investment* is the current product set aside during a given period to be used for future production; in other words, an addition to the stock of capital goods. As measured by the national income and product accounts, private domestic investment consists of investment in residential and nonresidential structures, producers' durable equipment, and the change in business inventories. *Financial investment* is the purchase of a financial security. *Investment in human capital* is spending on education, training, health services, and other activities that increase the productivity of the work force. Investment in human capital is not treated as investment in the national income and product accounts.

long-term interest rate: Interest rate earned by a note or bond that matures in 10 or more years.

mandatory spending: Another term for **direct spending**.

marginal tax rate: Tax rate that applies to an additional dollar of taxable income.

means of financing: Sources of financing federal deficits or uses of federal surpluses. The largest means of financing is normally federal borrowing from the public, but other means of financing include any transaction that causes a difference between the federal (including off-budget) surplus or deficit and the change in debt held by the public. The means of financing include changes in checks outstanding and Treasury cash balances, seigniorage (that is, government revenue from the manufacture of money), and the transactions of the financing accounts established under credit reform.

means-tested programs: Programs that provide cash or services to people who meet a test of need based on income and assets. Most means-tested programs are entitlements--for example, Medicaid, the Food Stamp program, Supplemental Security Income, family support, and veterans' pensions--but a few, such as subsidized housing and various social services, are funded through discretionary appropriations.

national saving: Total saving by all sectors of the economy: personal saving, business saving (corporate after-tax profits not paid as dividends), and government saving (budget surplus or deficit--indicating dissaving--of all government entities). National saving represents all income not consumed, publicly or privately, during a given period. (Bureau of Economic Analysis)

net interest: *In the federal budget,* net interest includes federal interest payments to the public as recorded in budget function 900. Net interest also includes, as an offset, interest income received by the government on loans and cash balances. *In the national income and product accounts* (NIPAs), net interest is the income component of GDP paid as interest--primarily interest that domestic businesses pay, less interest they receive. The NIPAs treat government interest payments as transfers, so they are not part of GDP.

nominal: Measured in the dollar value (as in nominal output, income, or wage rate) or market terms (as in nominal exchange or interest rate) of the period under consideration. Compare with **real.**

off-budget: Spending or revenues excluded from the budget totals by law. The revenues and outlays of the two Social Security trust funds and the transactions of the Postal Service are off-budget and (except for discretionary Social Security administrative costs) are not included in any Budget Enforcement Act calculations.

offsetting receipts: Funds collected by the federal government that are recorded as negative budget authority and outlays and credited to separate receipt accounts. More than half of offsetting receipts are intragovernmental receipts that reflect agencies' payments to retirement and other funds on behalf of their employees; these receipts simply balance payments elsewhere in the budget. An additional category of receipts (proprietary receipts) come from the public and generally represent voluntary, business-type transactions. The largest items are the flat premiums for Supplementary Medical Insurance (Part B of Medicare), timber and oil lease receipts, and proceeds from the sale of electric power.

outlays: The liquidation of a federal obligation, generally by issuing a check or disbursing cash. Sometimes obligations are liquidated (and outlays occur) by issuing agency promissory notes, such as those of the former Federal Savings and Loan Insurance Corporation. Unlike outlays for other categories of spending, outlays for interest on the public debt are counted when the interest is earned, not when it is paid. Outlays may be for payment of obligations incurred in previous fiscal years or in the same year. Outlays, therefore, flow in part from unexpended balances of prior-year budget authority and in part from budget authority provided for the current year.

pay-as-you-go: A procedure required in the Budget Enforcement Act of 1990 to ensure that, for fiscal years 1991 through 1995, legislation affecting direct spending and receipts does not increase the deficit. Pay-as-you-go is enforced through Congressional rules and sequestration procedures. The pay-as-you-go process was extended through fiscal year 1998 by the Omnibus Budget Reconciliation Act of 1993.

potential real GDP: The highest level of real GDP that could persist for a substantial period without raising the rate of inflation. CBO's calculation relates potential GDP to the nonaccelerating inflation rate of unemployment, which is the unemployment rate consistent with a constant inflation rate. (CBO)

present value: A single number that expresses a flow of current and future income (or payments) in terms of an equivalent lump sum received (or paid) today. The calculation of present value depends on the rate of interest. For example, given an interest rate of 5 percent, today's 95 cents will grow to $1 next year. Hence, the present value of $1 payable a year from today is only 95 cents.

productivity: Average real output per unit of input. Labor productivity is average real output per hour of labor. The growth of labor productivity is defined as growth of real output that is not explained by growth of labor input alone. Total factor productivity is average real output per unit of combined labor and capital inputs. The growth of total factor productivity is defined as the growth of real output that is not explained by the growth of labor and capital. Labor productivity and total factor productivity differ in that increases in capital per worker would raise labor productivity but not total factor productivity. (BLS)

real: Adjusted to remove the effect of inflation. *Real (constant dollar) output* represents volume, rather than dollar value, of goods and services. *Real income* represents power to purchase real output. *Real data* are usually constructed by dividing the corresponding nominal data, such as output or a wage rate, by a price index or deflator. *Real interest rate* is a nominal interest rate minus the expected inflation rate. Compare with **nominal**.

recession: A phase of the business cycle extending from a peak to the next trough--usually lasting six months to a year--characterized by widespread declines in output, income, employment, and trade in many sectors of the economy. Real GDP usually falls throughout a recession. (NBER)

reconciliation: A process the Congress uses to make its tax and spending legislation conform with the targets established in the budget resolution. The budget resolution may contain reconciliation instructions directing certain Congressional committees to achieve deficit reduction through changes in tax or spending programs under their jurisdiction. Legislation to implement the reconciliation instructions is usually combined in one comprehensive bill. The reconciliation process primarily affects taxes, entitlement spending, and offsetting receipts. As a general rule, decisions on defense and nondefense discretionary programs are determined separately through the appropriation process, which is also governed by allocations in the budget resolution.

recovery: A phase of the business cycle that lasts from a trough until overall economic activity returns to the level it had reached at the previous peak. (NBER)

sequestration: The cancellation of budgetary resources to enforce the discretionary spending caps and pay-as-you-go process established under the Budget Enforcement Act of 1990 and the Omnibus Budget Reconciliation Act of 1993. Sequestration is triggered if the Office of Management and Budget determines that discretionary appropriations exceed the discretionary spending caps, that legislation affecting direct spending and receipts increases the deficit, or that the deficit exceeds--by more than a specified margin--the maximum deficit amount set by law. Failure to meet the maximum deficit amount would trigger across-the-board spending reductions. Changes in direct spending and receipt legislation that increase the deficit would result in reductions in funding from entitlements not otherwise exempted by law. Discretionary spending in excess of the caps would cause the cancellation of budgetary resources within the appropriate discretionary spending category.

short-term interest rate: Interest rate earned by a debt instrument that will mature within one year.

ten-year Treasury note: Interest-bearing note issued by the U.S. Treasury that is redeemed in 10 years.

three-month Treasury bill: Security issued by the U.S. Treasury that is redeemed in 91 days.

transfer payments: Payments in return for which no good or service is currently received--for example, welfare or Social Security payments or money sent to relatives abroad. (Bureau of Economic Analysis)

trust fund: A fund, designated as a trust fund by statute, that is credited with income from earmarked collections and charged with certain outlays. Collections may come from the public (for example, taxes or user charges) or from intrabudgetary transfers. More than 150 federal government trust funds exist, of which the largest and best known finance several major benefit programs (including Social Security and Medicare) and certain infrastructure spending (the Highway and the Airport and Airway trust funds). The term "federal funds" refers to all programs that are not trust funds.

unemployment: Joblessness. The measure of unemployment is the number of jobless people who are available for work and are actively seeking jobs. The *unemployment rate* is unemployment as a percentage of the labor force. (BLS)

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